Tobacco DOJ

Total Pages: ____

LRM ID: RJP186

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
Washington, D.C. 20503-0001

Wednesday, February 4, 1998

URGENT

LEGISLATIVE REFERRAL MEMORANDUM

TO:	Legislative Liaison Officer - See Distribution below
FROM:	Janet R. Forsgren (for) Assistant Director for Legislative Reference
OMB CONTACT:	Robert J. Pellicci PHONE: (202)395-4871 FAX: (202)395-6148
SUBJECT:	**JUSTICE Testimony on civil liability portions of the proposed tobacco settlement**
DEADLINE:	**NOON Wednesday, February 4, 1998**

In accordance with OMB Circular A-19, OMB requests the views of your agency on the above subject before advising on its relationship to the program of the President. **Please advise us if this item will affect direct spending or receipts for purposes of the "Pay-As-You-Go" provisions of Title XIII of the Omnibus Budget Reconciliation Act of 1990.**

EXECUTIVE OFFICE OF THE PRESIDENT

COMMENTS: Hearing is scheduled before the House Judiciary Committee tomorrow, February 5th. **DEADLINE IS FIRM.**

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LRM ID: RJP186 **SUBJECT:** JUSTICE Testimony on civil liability portions of the proposed tobacco settlement

RESPONSE TO
LEGISLATIVE REFERRAL
MEMORANDUM

If your response to this request for views is short (e.g., concur/no comment), we prefer that you respond by e-mail or by faxing us this response sheet. If the response is short and you prefer to call, please call the branch-wide line shown below (NOT the analyst's line) to leave a message with a legislative assistant.

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_____ No Objection

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_____ See proposed edits on pages _________

_____ Other: ______________________

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PREPARED STATEMENT OF DAVID W. OGDEN, COUNSELOR TO THE ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE

Mr. Chairman, I am pleased to testify today on behalf of the Department of Justice regarding the civil liability portions of the proposed tobacco settlement.

I. Introduction

On September 17th of last year, and again in his State of the Union speech, the President made clear his strong desire to work with this Congress in a bipartisan fashion to enact national tobacco legislation. For our part, the Justice Department is eager to work closely with this Committee and the Congress to ensure that sound, comprehensive legislation is enacted. Smoking and the use of smokeless tobacco have had a devastating impact on our society in terms of death and human suffering. This cycle of disease and death is renewed each day, as 3,000 children and teenagers begin smoking regularly. The President and this Congress are faced with an historic opportunity -- and profound responsibility -- to address one of this country's greatest single health problems. We praise the hard work and leadership of the President, the states' attorneys general and other public health advocates, whose unwavering efforts have been instrumental in creating this opportunity. We offer the following remarks in the hope of facilitating the development and passage of comprehensive national legislation regarding tobacco products.

II. Events Leading up to the Present Consideration of the Proposed Tobacco Settlement

Working closely over the last several years, State and Federal officials have dramatically altered the legal landscape faced by the tobacco industry. For decades, individuals harmed by the use of tobacco had little recourse -- those that sued the tobacco companies always lost and regulatory agencies took no action to regulate tobacco to prevent future harm. This situation began to change in 1994, when the Administration, prompted by an epidemic of tobacco use by teenagers, authorized the Food and Drug Administration (FDA) to conduct an extensive investigation of the tobacco industry with an eye toward determining whether nicotine-containing tobacco products should be subject to FDA regulation. Based on that investigation, the FDA promulgated regulations aimed at the reduction of youth smoking. In April 1997, a federal district court in North Carolina affirmed the FDA's authority to regulate tobacco products. (This decision is currently on appeal.)

During the same period, the tobacco industry has been sued in many fora. Since 1994, forty-two states have sued the major tobacco companies in an effort to recover smoking-related health care costs. In addition, many private lawsuits have been filed by those who claim to have been injured by smoking. On June 20, 1997, the states and the companies reached a tentative settlement to most of these actions, contingent upon enactment of appropriate federal legislation. This agreement is embodied in the proposed settlement. The industry has already settled lawsuits in three states where trial was imminent (Mississippi, Florida, and Texas). Trial in the Minnesota case brought by Attorney General Hubert Humphrey, III, began on January 20, 1998, in St. Paul.

After reviewing the settlement, the President on September 17, 1997 called for comprehensive tobacco legislation with a goal of reducing teen smoking by 50 percent within seven years. The President stressed five key elements that must be at the heart of any national tobacco legislation:

1. a comprehensive plan to reduce teen smoking, including a combination of penalties and price increases that raise cigarette prices by up to $1.50 per pack over the next 10 years as necessary to meet youth smoking targets;
2. express reaffirmation that the FDA has full authority to regulate tobacco products;
3. changes in the way the tobacco industry does business, especially in the area of advertising directed at children;
4. progress toward other critical public health goals, such as the expansion of smoking cessation and prevention programs and the reduction of secondhand smoke; and
5. protection for tobacco farmers and their communities.

During his State of the Union address last week, the President again forcefully emphasized that his top priority is the reduction of underage smoking. Of the three thousand young people who begin smoking each day in America, one thousand will die prematurely from tobacco-related diseases. Reducing teen smoking is the most important step that Congress and the Administration can take now towards protecting the Nation's health in the next century and minimizing future health care costs.

III. The Civil Liability Provisions

A. A Summary of the Provisions

The civil liability provisions of the settlement contemplate federal legislation that would work major changes in the current tort liability regime. Broadly speaking, such federal legislation would provide an annual cap on the industry's potential liability in civil actions, eliminate punitive damages for past industry misconduct, and impose various procedural restrictions on parties who would sue tobacco companies for smoking-related injuries. I will address the specific provisions individually in a moment, but first I want to identify general principles we believe should govern their consideration.

B. Guiding Principles When Analyzing the Civil Liability Provisions

Our civil justice system exists to provide means of redress for individuals who are harmed by the conduct of others and to deter such harmful conduct in the future. These are very important goals, and their achievement is fundamental to any just society. Although the existing tort system is certainly not perfect or the only way to achieve these goals, it has as a general matter served them well. For that reason, the structure of the tort system should not be modified except for important reasons. Nor should tobacco companies become special favorites of the law.

Nevertheless, it is essential to consider proposed modifications of the tort system in the larger context of this legislation, in service not only of the compensatory and deterrence objectives of the tort system itself, but also of the compelling public health obligations identified by the President. Although some states have recently achieved large settlements with the tobacco companies, the victims of tobacco-related diseases, to date, have received virtually nothing in the form of compensation through the tort system. Nor has that system until now deterred industry misconduct, such as marketing cigarettes to minors. Litigation alone will not reduce youth smoking; only comprehensive legislation addressing price, access, marketing, and other industry practices will be enough to achieve this objective. Reasonable provisions modifying the civil liability of the tobacco industry thus would be acceptable to the Administration, but only in the context of a comprehensive bill that advances the public health by fulfilling the President's five principles -- reducing youth smoking by substantially raising the price of cigarettes and imposing tough penalties on the industry; expressly confirming the full authority of the FDA; changing the way the industry does business; achieving other public health goals; and protecting tobacco farmers. We also believe such provisions should be crafted to make more achievable the recovery of appropriate compensation for deserving injured parties than historically has been the case and to reinforce the legislation's other, comprehensive safeguards against industry misconduct.

I want to highlight specific principles that we believe must guide our analysis of any proposed modifications to the civil liability system as they apply to tobacco:

- Any legislation proposing changes in the civil liability system must be consistent with the President's goals of reducing teen smoking, improving public health by confirming the full authority of the Food and Drug Administration, and changing the way tobacco companies do business;
- Legislation should make deterrence of industry misconduct more effective -- and compensation of victims more fair -- than historically has been the case;
- Because civil suits provide an important tool for discovering the truth, any final settlement should create powerful incentives for tobacco manufacturers to fully and publicly disclose all appropriate documents; and

- Any changes to the civil justice system must be constitutionally sound.

C. A Description of the Civil Liability Provisions and Some Questions Raised

Let me turn now to the provisions of the proposed settlement.

The proposed settlement leaves open many questions. No definite terms establish who or what will be paid or for how long. The settlement is more of a template for constructing a legislative solution than a traditional out-of-court settlement of the state lawsuits and the numerous individual and class action lawsuits. Nonetheless, some initial observations are possible.

There are four broad areas in which the proposed settlement would affect the civil liability system.

1. Resolution of Pending Litigation

The settlement contemplates that much of the pending litigation would be settled, including the present states attorneys general actions. It appears that the settlement also contemplates that future litigation of those kinds would be prohibited by federal law. Pending addiction/dependence claims by injured smokers also apparently would be settled.

2. Limits on Annual Liability

The settlement contemplates federal legislation that would impose limits on the annual aggregate and individual damage payments for which the participating tobacco manufacturers could be liable. An "annual aggregate cap" for the payment of judgments and settlements would begin at $2 billion in the first year and increase to $5 billion in the ninth year and thereafter. If total judgments and settlements for a given year exceeded the annual aggregate cap, the excess would be rolled over for payment in future years. Payments would be limited to $1 million per judgment per year unless every other judgment and settlement could first be satisfied in that year without exceeding the annual cap. Unpaid individual judgments in excess of the individual cap would be rolled forward, without interest, for payment in future years.

The annual caps proposed in the settlement could be modified in various ways. Limits could be established on the amount paid in each lawsuit or could be imposed only on future claims, or only on past ones. Within the context of the settlement as a whole, we should explore whether liability caps can be part of a creative scheme that also furthers the goals discussed earlier.

One critical issue, of course, is whether the annual caps or other mechanisms would afford sufficient funds to meet the needs of victims or whether they should be raised. It may be valuable for Congress to ask that the tobacco manufacturers share their calculations and research concerning the likely dollar requirements of those injured by tobacco products. We are prepared to work with Congress on that issue.

3. <u>Limits on Punitive Damages</u>

Under the settlement, all punitive damages claims would be extinguished with respect to conduct taking place prior to the effective date of the bill enacting the settlement. Punitive damages could be awarded with respect to conduct taking place after passage of the legislation.

The purpose of punitive damages is to deter and punish. Congress is being asked to remove this tool with respect to the tobacco manufacturers' past conduct. At the same time, however, Congress is considering legislative provisions that will serve similar purposes. In deciding upon appropriate punitive damages provisions, Congress should consider the overall legislative package and the framework it establishes for deterring future wrongdoing and serving the public interest. Moreover, Congress could consider other alternatives such as capping punitive damages or -- perhaps most interestingly -- retaining punitive damages with respect to claims based on facts not disclosed by the tobacco manufacturers to Congress and the public. Finally, with respect to any of these proposals, Congress will have to look carefully at the constitutionality of the proposed legislation.

4. Procedural Restrictions

The settlement apparently contemplates federal legislation that would abolish class actions and other forms of multi-case tobacco litigation without the defendants' consent. Litigation brought by third party plaintiffs, such as pension funds and health insurers, would be prohibited entirely unless the litigation was based on the subrogation of a single individual's personal injury claim. Third-party payor claims that were pending on June 9, 1997, would be allowed under a grandfather clause.

It has been difficult to bring class actions for tobacco-related injuries in federal courts, and many state courts have denied class certification. Some state courts have granted class certification to claimants against the tobacco manufacturers, however, and other joinder mechanisms that would be affected by the proposal can significantly reduce individual litigant's costs of suit. Restrictions on such joinder mechanisms could make it more difficult for some plaintiffs to pursue their claims in court. Such restrictions also raise novel federalism issues. Thus, we believe that Congress should consider carefully the legal and practical consequences of such provisions, and consider in tandem with them the adoption of rules or mechanisms that improve injured tobacco users' access to justice.

V. Conclusion

The Department of Justice strongly supports comprehensive tobacco legislation. Crafting legislation that significantly reduces teenage tobacco use and meets the other goals the President has announced is an enormous, yet vitally important, challenge. We would be happy to join with this Committee in a dialogue to find the best possible solution.

Thank you for giving me this opportunity to furnish the views of the Department of Justice regarding this legislation. I will be pleased to answer any questions you may have.

FAX TRANSMISSION

Princeton University: Woodrow Wilson School
of Public and International Affairs
438 Robertson Hall
Princeton, NJ 08544-1013
Phone: (609) 258-4818 Fax: (609) 258-2649

tobacco

Please deliver to: Mr. Bruce Reed

Organization: Domestic Policy Council / The White House

Fax number: (202)456-2878

Sender's Name: Kristen Rassiger

Sender's Phone: (609)258-7703

Date of Transmission: 10/29/97

Total number of pages (including cover page): 2

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- [ ] Policy Task Force
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Princeton University
Princeton, NJ 08544

Mr. Bruce Reed
Assistant to the President for Domestic Policy
White House Domestic Policy Council
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

I emailed her

October 29, 1997

Dear Mr. Reed:

Tom Freedman suggested that I contact you. I am a junior at Princeton University, majoring in the Woodrow Wilson School of Public Policy and International Affairs. As part of my independent work, I am enrolled in a policy conference on tobacco regulation. I am attempting to write my Junior Paper on the importance of Clinton's anti-smoking initiative to the values campaign of '96 and the role that tobacco regulation should play in reversing the moral crisis of the 90s.

I understand that you are in charge of tobacco policy. If you are available, I would truly appreciate the opportunity to speak with you. An interview with you would be an asset to my research. I would be very grateful if you could spare even a short time to talk with me. I am on fall break for the rest of the week and can easily make it down to D.C. whenever you are free. If meeting in person is not a possibility, I would appreciate a phone interview.

Please let me know your availability at your earliest convenience. My telephone number is (609) 258-7703. I can also be reached through e-mail--rassiger@princeton.edu. Thank you so much for your time and consideration.

Sincerely,

Kristen M Rassiger

Kristen M. Rassiger

Que term suits — L.A.T. — suit on behalf of fed'l gov't tobacco – medicaid

DRAFT DRAFT 10/24/97

Dear State Medicaid Director:

A number of States have settled suits against one or more tobacco companies to recoup costs incurred in treating tobacco-related illnesses. I am writing to all States about the proper accounting and reporting for Federal Medicaid purposes of amounts received from such settlements pursuant to Section 1903 (d) of the Social Security Act.

As with any recovery related to a Medicaid expenditure, payments received should be reported on the Quarterly Statement of Expenditures for the Medicaid Assistance Program (HCFA-64) for the quarter in which they are received. Specifically, these receipts should be reported on the Form HCFA-64 Summary Sheet, Line 9E. This line is reserved for special collections. The Federal share should be calculated using the current Federal Medicaid Assistance Percentage. Please note that settlement payments represent a credit applicable to the Medicaid program irrespective of whether the monies are received directly by the State Medicaid agency or not. States that have previously reported receipts from tobacco litigation settlements must continue to report settlement payments as they are received.

To the extent that some non-Medicaid expenditures and/or recoveries were also included in the underlying lawsuits, HCFA would accept an allocation reflecting the Medicaid portion of the recovery. As always, HCFA is open to discussions on appropriate allocation proposals within the constraints of the statutory requirements with regard to Medicaid recovery. It will be a State's responsibility to provide necessary documentation to support a proposed allocation.

State administrative costs incurred in pursuit of Medicaid cost recoveries from tobacco firms qualify for the normal 50 percent Federal financial participation (FFP). They should be reported on the Form HCFA-64.10, Line 14 (Other Financial Participation).

The Administration's goal for any comprehensive tobacco legislation considered by Congress is that all affected parties -- such as the States -- be involved in the process and have the opportunity to have their concerns addressed. In that forum, it will be appropriate for the States to propose althernative dispositions of third party recoveries for tobacco-related illnesses. Until any legislative change, however, the States' current obligations are as described above.

If you would like to discuss the appropriate reporting of recoveries with HCFA, please call at to arrange for a meeting or conversation. We look forward to providing any assistance needed in meeting a State's Medicaid obligation.

HHS emphasis

Sincerely,

THE WHITE HOUSE

WASHINGTON

September 30, 1997

Lw

MEETING WITH BIPARTISAN CONGRESSIONAL LEADERS ON TOBACCO

DATE: Wednesday, October 1, 1997
LOCATION: The Diplomatic Room
TIME: 11:15-12:15
FROM: Bruce Reed
John Hilley

I. PURPOSE

To fulfill your commitment to meet with the bipartisan leadership of Congress to launch an effort to enact federal tobacco legislation. This will be an opportunity to demonstrate that this is a priority in your agenda and that you will reach out across party lines to advance this critical public health initiative.

II. BACKGROUND

The Administration is in a strong position to push tobacco legislation through Congress over the next year. Your announcement earlier this month united the public health community for the first time and attracted bipartisan support from the nation's Attorneys General and many members of Congress.

Nevertheless, any tobacco bill will have to make its way through a tangle of overlapping committee jurisdictions and agendas. At least six committees in the Senate and four in the House can lay claim to some piece of this legislation, and dozens of members in both parties have a longstanding interest in tobacco from the standpoint of reducing teen smoking or protecting tobacco farmers. Republicans in particular recognize the political potency of the your plan, and are very nervous about being set up for failure in an election year.

The first step must therefore be to reassure the leadership and key committee chairs like Rep. Bliley that the Administration is indeed serious about passing a bipartisan bill, and not just looking to sandbag them in an election year. This meeting is an important opportunity to set the right tone: you are eager to work together to pass bipartisan legislation as early as possible next year, and we are ready to work in a collaborative fashion to get it done.

Our next step should be for representatives of the Administration (including the Vice-President, Erskine Bowles, Secretary Shalala, Secretary Glickman, John Hilley, and Bruce Reed) to meet with the key players in both parties over the remaining weeks of this session, to offer the Administration's expertise and to try to marshal bipartisan coalitions in both houses to prepare bills for introduction in January. It is too early to tell which members are in the best position to lead that effort. (Bliley is a key House Republican; Waxman and Fazio are important House Democrats; Hatch, Lugar, McCain, Jeffords, Mack, Campbell and several Republican moderates may be helpful in the Senate; Conrad, Lautenberg, Kennedy, and others are strong Senate Democrats.) Ideally, we can lay the groundwork for a center-out coalition in the Senate, along the lines of Hatch-Kennedy or the Breaux-Chafee group, and work closely with Bliley, Waxman, and others in the House.

Senate committees have held several hearings on tobacco over the past three months. Secretary Shalala testified before Jeffords' committee last week. The House may hold hearings in late October and early November.

The goal should be to forge a bipartisan vehicle you can endorse in January, and to make that the central focus of next year's State of the Union.

Opponents of the legislation will make three types of arguments to slow it down. First, Nickles and others have criticized the Administration for failing to submit full legislative language to Congress and blamed the Administration for any delay in passage of a bill. Second, some will use the complexity of the issue as an excuse to go slow -- perhaps moving only selected portions a bill, and that only after lengthy hearings. Finally, opponents of legislation may focus on flashpoints such as farmers, restrictions on class action suits, or legal fees.

The strongest response to these expected attacks is to rise above partisan bickering, and stress the urgency of solutions that will protect America's children. Your strong history of leadership on smoking issues will allow you to deploy this strategy effectively and gain public support in any future disagreements with Congress.

III. PARTICIPANTS

<u>Pre-Brief:</u>
The President
The Vice President
Secretary Glickman
Secretary Shalala
Secretary Rubin
Erskine Bowles
Bruce Reed
Rahm Emanuel
Dan Tate
Elena Kagan
Bruce Lindsey
Ron Klain
Chris Jenning

Brief:
Please see attachment.

IV. PRESS PLAN

The meeting is closed to the press. The members of Congress will have an opportunity to meet the press outside the White House following the event.

V. SEQUENCE OF EVENTS

You will make remarks and recognize the Vice President Speaker Gingrich, Senator Daschle and Representative Gephardt for statements.

VI. REMARKS

Please see attachment.

PARTICIPANTS Attachment

The President
The Vice President
Secretary Glickman
Secretary Shalala
Secretary Rubin
Erskine Bowles
Bruce Reed
Rahm Emanuel
Dan Tate
Elena Kagan
Bruce Lindsey
Ron Klain
Chris Jennings
Don Gips

Senator Tom Daschle
Representative Newt Gingrich
Representative Dick Gephardt

Senator Richard Lugar (R-IN), Chair, Senate Committee on Agriculture
Senator Tom Harkin (D-IA), Ranking Democrat, Senate Committee on Agriculture
Senator John McCain (R-AZ), Chair, Senate Committee on Commerce
Senator Orrin Hatch (R-UT), Chair, Senate Committee on Judiciary
Senator Patrick Leahy (D-VT), Ranking Democrat, Senate Committee on Judiciary
Senator Jim Jeffords (R-VT), Chair, Senate Education and Labor Committee
Senator Edward Kennedy (D-MA), Ranking Democrat, Senate Education and Labor Committee
Senator Daniel Inouye (D-HI), Ranking Democrat, Senate Committee
Senator Frank Lautenberg (D-NJ)
Senator Kent Conrad (D-SD)
Senator Don Nickles (R-OK)

Representative Bob Smith (R-OR), Chair, House Committee on Agriculture
Representative Tom Bliley (R-VA), Chair, House Committee on Commerce
Representative Henry Hyde (R-IL), Chair, House Committee on Judiciary
Representative John Conyers (D-MI), Ranking Democrat, House Committee on Judiciary
Representative Henry Waxman (D-CA)
Representative Vic Fazio (D-CA)
Representative Scott McInnis (R-CO)

REMARKS Attachment

*	Thank you for coming to talk about this vital issue for America's future. (Acknowledge Gingrich, Gephardt, Nickles, Daschle, Bliley) This is an issue that touches on many aspects of American life -- our health, our economy, our laws, and our children -- and I want to acknowledge the hard work of so many of you in this room on this issue. In particular, I want to thank the Vice-President for his very important contribution. You are all here because of the critical role you will play as we work to pass legislation together. It is complicated, but I'm confident we can put politics aside and get this done.

*	You and I are here because this is a crucial issue for America's future. Three thousand kids start smoking everyday, and it shortens the lives of one thousand of them. As I've said before, this is not about money, and it shouldn't be about politics. It should be about trying to reduce this problem of teen smoking. Interestingly, today is the day that the childrens' health provisions in our Bipartisan Balanced Budget Agreement go into effect. I hope that we can work together again in that same bipartisan fashion to reduce teen smoking and advance the public health.

*	Two weeks ago, I outlined the most significant elements I thought should be contained in a bill. That we reduce teen smoking with tougher penalties, that we not hamstring FDA authority to regulate tobacco, that we make some changes in the way tobacco is marketed, that we make more progress on other health goals like cancer research and second hand smoke. Finally, and this is very important to me, that we protect farmers and their communities.

*	**This should not be a partisan issue. I'm going to put it at the top of my agenda for the next year, and I hope you will join me in making bipartisan legislation to reduce teen smoking a top priority for all of us in 1998.**

*	This bill will go through many committees and it affects many people and many states. It is not going to happen by fiat, but after you hold hearings, and work through the difficulties of legislation. And I'm sure we will have our differences. But this is too important for us not to get done. And it can't wait until we all agree on every word. We should work together and try to move ahead.

*	I've said what I believe is most important here. I've asked several members of my administration -- led by the Vice-President and my Chief of Staff Erskine Bowles, along with Secretary Shalala, Secretary Glickman, and Bruce Reed-- to work side by side with you to get this done.

*	But I asked you here not just to tell you what I think about the issue but to hear what you think-- how we can work together, how we can get this done. So I'll ask Vice-President Gore to give some of his thoughts, and I'd like to hear what directions you are going to take on tobacco legislation, where the problems might be and how we can work together.

QUESTIONS AND ANSWERS

Q. Why don't you submit legislation on tobacco?

A. We're happy to offer Congress our expertise and any other help in translating our principles into bipartisan legislation. I don't think there is any doubt where I stand. The five principles I set out in my plan are very clear. This is the first time I can remember Congress asking us to write the bill -- I recall a somewhat different reaction when we sent up legislation on health care. Members should introduce legislation, hold hearings and move for votes and I will play as constructive a role as possible.

Q. When should a bill pass?

A. It is at the top of my agenda for the coming year. There is nothing more important than saving thousands of children from taking up smoking. Three thousand are starting everyday.

Q. Will negotiations include industry?

A. The industry is a piece of this, but there isn't a need to negotiate with them.

Q. What is the role of the Vice-President?

A. The Vice-President will take a leadership role in the legislation and in building support for our plan.

Q. Will you support limits on liability?

A. I've said repeatedly that a cap on liability wouldn't be a deal breaker for us. But if we're going to do that, we should make sure we're passing a strong comprehensive plan to cut teen smoking.

DRAFT

September 11, 1997

MEMORANDUM FOR THE PRESIDENT

FROM: Donna Shalala
Bruce Reed

SUBJECT: Tobacco

This memorandum (1) details the Administration process to review the proposed tobacco settlement; (2) describes the current context regarding tobacco; (3) analyzes the substantive terms of the settlement and presents recommendations and options for an Administration proposal on tobacco; and (4) raises certain strategic questions.

I. ADMINISTRATION REVIEW OF SETTLEMENT

The Administration has engaged in an intensive review of the settlement on two fronts. Internally, four work groups were created and dozens of officials from across the Administration participated in their reviews. These work groups were: Regulatory Issues; Program and Budget Issues; Legal Issues; and, Industry Performance and Accountability Issues. They conducted a line-by-line analysis of the 68-page settlement document; in addition, they sought to explore alternative approaches to proposals contained in the settlement. This has not been done in an attempt to "fix" the settlement but rather to assess the adequacy of the settlement's provisions and to provide the Administration with the basis for articulating its positions and principles if a decision is made to encourage a legislative initiative.

Externally, the Vice President, Secretary Shalala and Bruce Reed met with individuals and groups representing a wide variety of views and interests to make certain that the Administration is aware of diverse viewpoints and has the benefit of expertise from outside the Administration. These consultations have been with public health and tobacco control organizations, state attorneys generals, tobacco industry lawyers, representatives of the smokeless and cigar industries, tobacco industry "whistle blowers," representatives of the retail, vending and the advertising industries, agricultural leaders from the Southeastern tobacco-growing states, and officials from the Brooke Group (Liggett). This broad range of viewpoints has informed the Administration's review and analysis. These consultations have made clear that any legislative proposal will be buffeted from many sides, several of which were not included in the negotiations among the state attorneys generals, plaintiffs' attorneys, and the tobacco industry.

II. EVENTS AND INTERESTS LIKELY TO SHAPE POLITICAL LANDSCAPE

While the proposed tobacco settlement presents the President with an opportunity to exercise again his leadership on this vital public health issue, there are many other factors beyond the settlement that shape the current landscape and will change it in the future. Some enhance the opportunity presented to the President; some limit it.

A. Public Health Community

Since the June announcement of the settlement, the public health community has become increasingly skeptical of the particular elements of the settlement and, more important, has become increasingly unified in their criticisms. At the same time, the public health community is willing to consider and back the possibility of a legislative solution. It should also be noted that the unity of the public health community can be easily fractured: While they generally agree on what's wrong with the settlement, they have different ideas on what good solutions would be.

The principal public health criticisms of the settlement are:

- Restricting FDA's authority in any fashion
- Proposing ineffective "look back" penalties on companies for not reducing underage smoking
- Limiting disclosure of industry documents
- Failing to increase the price of cigarettes sufficiently
- Preempting state and local restrictions that might be tougher than the settlement (the impact on additional state restrictions is unclear)
- Failing to address international tobacco control
- Limiting liability, i.e., eliminating past punitive damages and capping future punitive damages and eliminating class actions (The public health community will always have a lingering concern about limiting liability as the basis for a settlement. It is not only a desire to "punish" this industry, but also reflects a belief that the threat of litigation is needed to keep this industry in check.)

Moreover, there is a small but significant portion (American Lung Association, Stan Glantz, grass roots tobacco control groups like the state GASPS, and Public Citizen) of the public health community that believes the settlement should be scuttled entirely, not fixed. The public health community is well aware of all these tensions, and in fact, this community attempted to forge a consensus again in August. Representatives of 11 groups met August 8, and worked over the next two weeks to present the Administration with a consensus document. However, this "consensus" statement ended up saying little more than that the public health community would like to see a settlement reached and would be willing to work for it; they could not come to terms as to what the settlement should in fact look like. Also, this "consensus" statement does not preclude individual groups from identifying issues of particular concern for them and actively seeking support in Congress for their viewpoint.

B. Lawsuits and Disclosure

A number of tobacco lawsuits are proceeding: the second-hand smoke lawsuit in Florida by the airline attendants; various private lawsuits, both individual suits and class-actions; and the Medicaid lawsuits by the states, most importantly those in Texas and Minnesota because of their timing. Any verdict against the tobacco industry will be widely viewed as another reason either not to negotiate with the industry or to take a stronger stance against the industry on several elements in the proposal. On the other hand, a verdict for the industry is likely to be seen as a reason to move forward with a legislative solution and weakening our position in any negotiations.

Just as important as the impact of any verdict is the disclosure issue raised by these lawsuits. Especially in the Medicaid lawsuit in Minnesota, state attorneys hold out the prospect of new industry documents coming to light that go far beyond any disclosed to date. In Florida and Minnesota, preliminary findings of fraud and criminal activity were made by either judges or special masters, and previously privileged documents are now being reviewed for public disclosure (in Florida, documents were disclosed in early August; in Minnesota, it is expected documents would become public by early 1998 when the case goes to trial). In addition, there is the possibility of indictments and trials because of ongoing DOJ criminal investigations and the resulting disclosure of secret documents in that process. Because no one really knows what is in the still secret documents, one concern is that they reveal activity that would generate such public outrage, that any accommodation with the industry would be seen as "selling out." In addition, some tie the disclosure issue to consideration of whether the immunity provisions of the settlement are adequate. Some Democrats, such as Sen. Patrick Leahy, take the position that any consideration of limiting liability has to be predicated on full disclosure of the documents.

Another factor on the legal front is the industry challenge to the FDA rule. Oral arguments on the appellate case were made in the Fourth Circuit on August 11, and two of the three judges voiced skepticism of the FDA rule. We do not know when the three-judge panel of the Fourth Circuit Court of Appeals will rule. Appeal to the en banc Fourth Circuit and the Supreme Court is available.

C. Congress

The Congressional horizon is receding into 1998 very quickly. In recent days, several Congressional leaders have said that legislative action on the settlement is unlikely in 1997. The Senate Republican leadership has made tentative plans to consider any tobacco legislation piecemeal, with at least six different committees having jurisdiction over parts of the settlement: Commerce, Judiciary, Labor, Agriculture, Environment and Public Works, and Finance. The

House Republican leadership has not indicated how it wants to proceed, although Rep. Richard Armey has said he expects similar divided consideration in the House. In the Senate and House, the Democratic leaderships are attempting to hold together tobacco-state and tobacco-control Democrats and present a united front. The potential of working with Congressional Democrats on this issue is very real and would give the Administration significant leverage in dealing with the GOP leadership.

D. Farmers

With regard to the Hill, the approach the Administration takes toward the issue of helping tobacco farmers may be the most significant. The settlement's failure to deal with tobacco farmers provides a significant opening for the Administration. Even some GOP members who have traditionally been supportive of the industry -- like Rep. Thomas Bliley -- are now saying their main concern will be helping their farm constituency. The farmers who in the past have provided substantial political cover to the industry can now be separated from the companies if they believe that will be in their best interest.

E. Affected Industries

In addition to the agricultural interests, several other segments of the economy are going to watch any settlement closely, e.g., hospitality industry with regard to environmental tobacco smoke (ETS), advertising and retail industries with regard to advertising and access restrictions, the asbestos industry and trial lawyers with regard to immunity. Each of these industries will have to make decisions on how a settlement affects its interests and when it wants to weigh in on the Hill. There is every indication that all of these industries will be very active and are already seeking to line up support for their cause on the Hill.

III. REVIEW OF SUBSTANTIVE ISSUES RAISED BY SETTLEMENT

The rest of this memorandum analyzes key aspects of the proposed settlement and highlights strengths and weaknesses. In providing this analysis, we do not mean to suggest that you should propose "fixes" to the settlement when you discuss tobacco legislation next week. To the contrary, we believe (though there are some strong arguments to the contrary) that you should set forth your own principles and plan for tobacco legislation. The following analysis, however, helps to illuminate some of the questions you will have to answer in deciding what to propose and communicating your views to the public.

One important note: This memorandum contains numerous representations as to what the tobacco industry is, or is not, willing to accept. These representations refer to what the tobacco industry is saying today. We have no reason to believe that these, in fact, are bottom line positions of the industry.

A. FDA Authority

The first priority of the Administration in considering tobacco legislation should be to confirm and protect the jurisdiction of the FDA to regulate tobacco products -- including through the reduction or elimination of nicotine or other constituents.

Even as written, the settlement's provision on FDA jurisdiction had certain virtues. First, the provision specifically conferred jurisdiction to regulate tobacco products on the FDA, thereby removing the legal uncertainty now attending the FDA rule. Second, the provision established a "risk reduction" standard to guide the regulation of tobacco products in place of the "safety and efficacy" standard applicable to other drugs and devices. This change in standard could facilitate the FDA's regulation of tobacco products.

This provision of the settlement, however, also contained several glaring weaknesses. First, as you noted in your first comments on the settlement, the FDA would have to prove a negative in order to reduce or eliminate nicotine -- i.e., that the action would not create a significant demand for contraband products. Second, the FDA could not eliminate nicotine for a period of 12 years. Third, the FDA could not take any action to modify tobacco products without surmounting a number of procedural hurdles -- e.g., formal rulemakings -- not usually applicable to administrative action.

The public health community will demand -- and we believe the industry will grudgingly accept -- a legislative proposal that corrects these weaknesses. Any Administration proposal should eliminate the 12-year waiting period and the special procedural hurdles in the current settlement. It also should remove the necessity of the FDA's making a contraband finding. At one point, the industry proposed flipping the burden of proof on the contraband issue, so that the FDA could not take action if a party affirmatively demonstrated that doing so would create a significant contraband market. But even this approach puts too much weight on the contraband issue, which should be only one factor in the FDA's regulatory decisionmaking. To maintain maximum flexibility, one approach is to authorize the FDA to order changes to tobacco products based on a simple finding that this change would reduce the risk of the product to the public and is technologically feasible, after consideration of the full range of consequences of the change.

Recommendation: Call for legislation preserving FDA authority over tobacco products, unencumbered by procedural or substantive criteria that may diminish that authority, and ensuring that FDA remains flexible to meet the future health challenges of tobacco.

B. Lookback Penalties

The settlement sets ambitious targets for reductions in teen smoking of 30% in 5 years, 50% in 7 years, and 60% in 10 years. The most recent data show underage prevalence at 18.2% in 1996, which means approximately 3.5 million youths aged 13-17 are daily smokers. Because the settlement targets are based on youth prevalence over the past decade, which has averaged 15.2%, the declines from current levels necessary to comply with the agreement would have to be 42% over 5 years, 58% over 7, and 67% over 10.

It is extremely difficult to predict how much teen smoking would decline under the settlement. While teen smokers are particularly sensitive to price -- Treasury has assumed that a price increase of 10% will reduce youth prevalence by 7% (compared to 2.6% for adults), and some studies suggest youth smoking will drop as much as 12% for every 10% increase in price -- we have never had a price shock of this magnitude. The Treasury Department estimates that the combined price rise from the current settlement and the 15-cent excise tax increase in the budget agreement would be about 80 cents by year 5, resulting in a 20% decrease from current youth smoking levels -- still well short of the settlement targets. Restrictions on access and advertising should reduce youth smoking still further, but no one can truly estimate the combined effect of price increases, access and advertising restrictions, and whatever activity the industry might undertake to counter these changes.

Under the settlement, companies would have to pay $80 million for each percentage point they fall short, which is supposed to recapture the industry's projected profits from hooking that many young smokers. (The Treasury Department says a more accurate projection of profits would be $60 million a point, which is roughly equal to $80 million after taxes.) Public health groups have praised the idea of targets and penalties, but complain that the settlement does not give companies sufficient incentive to stop hooking teenagers. The major criticisms against the current penalties are that they are tax-deductible, abatable, capped at $2 billion in a given year, not company-specific, and too small to serve as a deterrent.

The companies say that they could accept penalties of $80 million a point that were not tax-deductible and could not be abated. They say they are unwilling to increase the price per point or to eliminate the $2 billion annual cap.

One alternative approach would be to measure the number of teenagers who smoke a particular company's brands, and assess a company-by-company surcharge of $1,000 (about 2 ½ times foregone profits) per teen smoker in excess of the youth reduction targets. A second approach would combine the company-by-company surcharge with a system of graduated penalties that get stiffer the more the industry misses the targets. For example, the industry could be required to pay $200 million for each point missed between 0 and 30 percent, $400 million for each point missed between 30 and 50 percent, and $600 million for each point missed between 50 and 60 percent. Under this approach, the penalties could reach as high as $1 a pack by year 10 if youth smoking failed to decline.

Recommendation: Call for legislation holding each tobacco company accountable for reducing the use of tobacco by youths and subjecting companies to serious financial loss for failing to meet targets.

Alternative penalty schemes are outlined further in the charts on funding options attached to this memorandum.

C. Marketing, Advertising, and Labeling

The advertising and marketing restrictions in the settlement are very strong. They include all the restrictions in the FDA rule -- most notably, requirements of black-on-white advertising and bans on tobacco brand names in non-tobacco merchandise. The district court struck down these restrictions as inconsistent with the FDA's statutory authority, and the issue is not likely to be resolved quickly in court. The settlement also includes restrictions on advertising and marketing going far beyond the FDA rule, such as restrictions on point-of-sale advertising and bans on outdoor advertising, Internet advertising, the use of human images and cartoon characters, and payments for tobacco product placement in movies and other media. The Justice Department believes that all of these restrictions are highly vulnerable to constitutional challenge and that some flatly violate the First Amendment.

The Department of Justice believes that these additional restrictions on advertising should not be part of any legislation, but only of the consent decrees or other contracts entered into by the industry and Attorneys General. To the extent the restrictions are part of the legislation -- or seen as a condition of the legislation -- serious constitutional issues will arise. To the extent the restrictions are part only of the settlement agreements, their chance of being upheld would be significantly increased. (Larry Tribe, among others, believes that so long as the advertising restrictions are a function only of consent decrees and private agreements, they raise *no* constitutional issues. The Justice Department, by contrast, thinks that a court *might* strike down these advertising restrictions, even if included only in consent decrees or contracts, on the ground that the government coerced the companies to enter into these contracts in an effort to accomplish indirectly what it could not do directly.)

Assuming the advertising restrictions are included in consent decrees and agreements, serious questions relating to enforcement of the advertising restrictions arise. Each Attorney General settling a suit by consent would be able to enforce the restrictions in his or her state. But what of states in which there is no consent decree? Or what of states with inattentive Attorneys General? The proposed settlement agreement makes reference to a binding "national protocol" -- a contract designed to enhance enforcement of the advertising restrictions (and other provisions) in the consent decrees. But there is no consensus on precisely who will sign the protocol or how it will work in practice. As the legislative process unfolds, we must keep a close eye on this scheme -- and especially on any legislative references to it -- to ensure that it provides an effective mechanism for enforcing the advertising restrictions while not increasing the vulnerability of the restrictions to constitutional challenge (by making their enforcement something other than a matter of simple contract law).

We also should insist on statutory confirmation of FDA authority over the advertising and marketing of tobacco products, as part of our broader effort to secure legislation conferring full regulatory authority on the FDA. This grant of authority is valuable even though the settlement agreements will go further than the FDA could, precisely because the FDA probably will not have authority to enforce the contracts between the industry and the states. With a specific grant of authority, the FDA itself could enforce the restrictions contained in its 1996 rule, as well as any other constitutionally permissible restrictions it might wish to impose in the future.

In addition to including restrictions on advertising, the settlement contains provisions to require "Canadian-style" warning labels -- i.e., strengthened warnings (such as "cigarettes cause cancer" and "smoking can kill you") that appear on 25% of the front or display panel of tobacco products, printed in alternating black-on-white or white-on-black type. These provisions would strengthen significantly the existing warning labels, both in the starkness of the message and in its size and placement on tobacco products.

Recommendation: Call for legislation making explicit FDA authority to regulate the advertising of tobacco products and toughening warning labels on cigarette products. (Make limited reference to the tobacco industry's agreement to restrict advertising and do not say anything to suggest that this agreement is a condition of legislation.)

D. Access and Licensing

The access and licensing provisions of the settlement significantly enhance the ability of the government to prevent youth access to tobacco products. The current FDA rule establishes 18 as the federal minimum age of sale, requires retailers to check photo identification of anyone under 27, bans vending machines and self-service displays from actual establishments accessible to children, and eliminates free samples and the sale of single cigarettes. The proposed settlement incorporates these access restrictions while also banning all cigarette vending machines and requiring tobacco products to be placed out of reach of consumers in any facility that children may enter. Even more important, the settlement would establish a retail licensing scheme to enforce these access restrictions. FDA and Treasury agree that such a system will significantly further your goal of reducing youth access to tobacco. Assuming adequate funding, legislation creating a licensing system could count as one of the principal virtues of the settlement agreement.

As written, however, the licensing provision of the settlement contains some important ambiguities. Most critically, the settlement is vague as to who -- state authorities, federal authorities, or some combination of the two -- will administer the licensing scheme. We are not yet in a position to make a final recommendation on this question. FDA's current inclination is to give responsibility for running the scheme to the states, but to retain the power to revoke licenses. We are not yet sure whether such an approach would work as a practical matter; neither are we certain whether it could be accomplished consistently with the Constitution. Rather than recommending a specific scheme, we should commit only to working with Congress and the Attorneys General on this question.

The settlement's licensing provision also now contains an inadequate penalty structure. Most troublesome, the settlement provides for permanent license revocation only after a licensee's tenth offense within two years. Because licensing officials are unlikely to conduct ten compliance checks on a single retailer in a two-year time frame, this provision is essentially meaningless. We should insist on strengthening the penalty scheme -- including by making mandatory revocation a real weapon -- without getting into a level of detail unsuitable at this stage of the process.

These provisions are not particularly high-profile. They have not attracted much attention, and nothing we say about them will alter the politics of the deal in either direction. But provisions, if strengthened and clarified along the lines suggested, could prove one of the ...ues of enacting tobacco legislation.

Recommendation: Call for legislation imposing strong access restrictions and establishing an effective retail licensing scheme with tough penalties.

Documents

For decades, the tobacco industry has failed to disclose essential facts in its possession about the dangers and addictiveness of tobacco products. In particular, the industry has used both the attorney-client and the work product privileges to cloak scientific research and findings -- and possibly to shield evidence of criminal or fraudulent behavior. The Attorneys General attempted to address this issue through creation of a special court to resolve all privilege claims made by the industry. Although the proposed system has certain virtues, it also suffers from serious defects. The industry is willing to make certain minor changes in the proposed scheme, ... will not accept changes recommended by the Justice Department and FDA. Even these changes will not satisfy the harshest critics of the settlement, such as Skip Humphrey.

The settlement calls for a national document depository and a three-judge panel (appointed by the Judicial Conference of the United States) to provide expedited rulings on whether documents should remain privileged. The Attorneys General fought hard for this provision for two essential reasons. First, anyone -- not just a litigant, but any member of the public (including the New York Times or David Kessler) -- could ask the panel to review allegedly privileged documents. In this sense, the settlement establishes a Freedom of Information Act for tobacco documents. Second, the requester would not have to make the normal showing required in litigation for *in camera* review of a document: a *prima facie* case ... the document is not privileged -- because, for example, it advanced a scheme of crime or ...ud.

The Justice Department, however, believes that this scheme, adopted without change, would pose serious dangers. DOJ points out that no one knows whether or how this panel will work -- whether the judges (or special masters appointed by them) will be competent; whether they will be so swamped with document requests as to create an enormous backlog; whether they will favor one side over the other. DOJ also notes that this panel will have sole authority to rule on claims of privilege. While under the current system many courts may adjudicate a claim of privilege (with a finding of privilege in one court often not precluding the opposite finding in another), the special three-judge panel's decisions would be binding in all courts in all litigation in the United States. On top of these Justice Department concerns, the FDA should have access to all documents -- even those rightfully privileged -- to determine whether they contain scientific or other health-related information (for example, reflecting the industry's extensive research on nicotine addiction) relevant to the regulation of tobacco products.

To meet these agency concerns, the Administration could offer alternative disclosure provisions. First, we could make any administrative disclosure process non-exclusive, so that a litigant could challenge a privilege claim in litigation even if the special panel had not completed review of the document in question or had ruled in favor of the company. (By contrast, a finding by the special panel that a document is not privileged would bind the company in all other proceedings.) Second, we could provide the FDA with access to all health-related documents, notwithstanding any claims of privilege.

The industry claims that it will not accept either of these changes, though it will accept a scheme allowing courts to rule on a privilege claim if the special panel has not yet done so. The industry also proposes adding a provision to the settlement to require each company to identify and disclose all health-related information contained in privileged documents, without turning over the documents themselves. Under this proposal, the special panel could find that a company had failed to disclose such information and levy substantial penalties. Finally, the industry has expressed a willingness to consider a different scheme for selecting the people to sit on the special panel.

On the other side, some in Congress and the public health community will find even the alternative provisions described above to be inadequate. These changes do not broadly abrogate the industry's attorney-client or work-product privileges. The Justice Department has expressed serious concerns about any such breach of the privilege, arguing that such an approach would undermine the privilege generally and would enable a tobacco company official charged with criminal conduct to assert a violation of his Sixth Amendment right to effective assistance of counsel. But some will demand the complete abrogation of the companies' attorney-client privilege as a term of the settlement -- or, even more broadly, insist (as Sen. Leahy, Rep. Waxman, and Attorney General Skip Humphrey already have done) that the tobacco companies disclose all privileged documents before any consideration of a settlement takes place.

Recommendation: Call for legislation ensuring broad disclosure of tobacco industry documents containing scientific and other health-related information.

Options:

A. Call for legislation creating exclusive document depository system <u>and</u> compelling release of scientific and other health-related information in allegedly privileged documents (but not documents themselves).

B. Call for legislation creating <u>non</u>-exclusive document depository system, compelling release of scientific and other health-related information in allegedly privileged documents, <u>and</u> providing the FDA with access to all such documents.

C. Call for legislation requiring full public disclosure of all allegedly privileged documents.

F. Environmental Tobacco Smoke

The best available scientific evidence indicates that environmental tobacco smoke (ETS) causes disease and death in non-smokers. The Environmental Protection Agency (EPA) classifies ETS as a Class A carcinogen and estimates that it is responsible for about 3,000 lung cancer deaths each year in non-smoking adults. The EPA also has found that ETS threatens the health of hundreds of thousands of children with asthma and other respiratory illnesses. Serious ETS restrictions, which ban smoking in public places or at work except in enclosed areas exhausted directly to the outside, reduce exposure to ETS and the harm it causes. At the same time, such restrictions lead many smokers to quit smoking entirely and many more to cut down. Indeed, among the many smoking cessation tools -- including substantial price increases -- ETS restrictions may well be the most effective.

All agree that the settlement's provision on ETS is extremely valuable. The proposed legislation would broadly prohibit smoking in public places, without preempting even stricter state or local laws. A remaining question is whether to exempt restaurants (but not fast food restaurants), bars, private clubs, hotel guest rooms, casinos, bingo parlors, and tobacco merchants from a broad ETS restriction. H.R. 3434, which the Administration supported, exempts restaurants (including fast food restaurants) and bars. The proposed rule on ETS that OSHA issued in 1994 does not include any exemption for the hospitality industry. HHS would prefer to cut back on the exception in the settlement, noting that many of the exempted work places pose the greatest threat to non-smokers. The Department of Labor (OSHA) would keep the exemption essentially as is on the ground that trying to include restaurants, casinos, etc. would make the whole provision politically unsalable.

Recommendation: Call for legislation imposing strict restrictions on smoking in public places.

Option: Include exception for some or all the hospitality industry (restaurants, casinos, etc.)

G. Liability and Other Legal Issues

The price of everything in the settlement agreement is, of course, protection from civil liability. The settlement limits total liability to $5 billion each year (with any unspent portion of a base $4 billion fund reverting to the government), prohibits class action and other joinder and consolidation devices, and eliminates punitive damage claims (but requires a payment of billions of dollars in punitive damages directly payable to the public). There is little doubt about the value of these provisions to the tobacco companies.

On the other hand, there is some debate about whether these provisions harm public health interests. The tort system, of course, generally serves to deter conduct that causes injury to health and safety. Many in the public health community believe that imposing caps on damages, eliminating punitive damages and barring class actions will diminish this deterrent effect and encourage the industry to cause still further harm. Others believe that these changes will not reduce deterrence (recall that $5 billion in annual compensatory damages is $5 billion more than the industry has ever paid before) -- or at least that they are more than outweighed by provisions putting into effect a comprehensive regulatory scheme to regulate future behavior. They also argue that making the companies pay a punitive damage award for past misconduct <u>to the public</u> (for use in health research, etc.) makes far more sense from a public health perspective than allowing such funds to go as windfalls to individual plaintiffs.

The Justice Department believes that we would further advance public health interests by insisting on the removal of any limits on punitive damages for <u>future</u> misconduct. In DOJ's view, we should make clear that plaintiffs can seek such awards, and that these awards shall not count toward or be subject to yearly limits. The continued potential for unrestricted punitive damages will support the regulatory aspects of the legislation in deterring willful misconduct and otherwise changing corporate behavior. At the same time, this change will enable the legal system to punish the industry, over and above compensatory damages, for any future misbehavior.

DOJ also has urged us to consider some changes to the prohibition on class actions, joinder, consolidation, and other aggregation devices. The first point to make about this prohibition is that there is a substantial risk that it would be invalidated as applied to state courts for violating the Tenth Amendment. Any provision of this kind thus would have to be accompanied by explicit severance language. In addition, DOJ would like to define the ban on aggregation more narrowly -- in particular, to allow some consolidation of cases prior to trial for purposes of conducting discovery and adjudicating pre-trial motions. This change, which would entail amendment of the current multidistrict litigation statute, would allow individual plaintiffs to share discovery materials and reduce discovery and other pre-trial costs. The industry apparently will resist any change to the provision on class actions, joinder, and consolidation. But given the cap on annual damages, it is hard to see why such changes matter so much to the industry. Moreover, the industry may see consolidation schemes of the kind DOJ would like to protect as less threatening than mechanisms (whether class actions or joinder rules) that permanently tie many cases together, letting numerous "bad facts" cases ride in the wake of a couple of "good facts" cases all the way to judgment.

The FTC and Antitrust Division of the Justice Department are both concerned about the breadth of the antitrust exemption contained in the proposed settlement agreement, noting that it might protect such activities as price-fixing, mergers to monopoly, predatory pricing, and agreements not to produce reduced-risk products. The FTC and Antitrust Division note that they presumptively disfavor exemptions to the antitrust laws and that any exemption for tobacco companies must be limited to what is strictly necessary to serve the purposes of our tobacco proposal. Though we do not have specific language, the general idea would be to allow collusion only where strictly necessary to accomplish the purpose of reducing youth smoking.

We also must insist that neither the settlement nor any eventual legislation (including provisions relating to documents) will apply to or have preclusive effect on federal grand jury investigations or criminal prosecutions. In particular, the settlements and legislation should include a so-called "Halper provision," by which the participating companies waive any argument that the civil penalties in the settlement constitute a bar under the double jeopardy clause to criminal prosecution.

Finally, the preemption provisions of the proposed settlement are among its most baffling aspects -- muddled, internally contradictory, and seemingly senseless. We should try to clarify them so that they preserve current FDA authority, while enabling states in appropriate circumstances to go beyond the provisions of the settlement agreement. More specifically, where existing law requires states to petition the FDA to regulate tobacco, states would remain under that obligation and the FDA would retain its current authority; where existing law allows states to regulate tobacco on their own, states could impose any regulations more stringent than the new federal standards. It is very difficult to know how much (if at all) this scheme deviates from what the drafters of the settlement intended. In any case, it is hard to imagine that the issue would drive any party from the table.

Recommendation: Condition limits on liability and aggregation (class actions, etc.) on complete satisfaction of all other demands, and insist on the availability of punitive damages for future misconduct. Make clear that federal legislation cannot in any way affect criminal prosecutions or more stringent state regulation.

H. Farmers

We have made clear that tobacco farmers should receive protection in any legislative settlement, and that the Administration will work closely with members of Congress from tobacco states to forge a consensus. Secretary Glickman has traveled to tobacco markets in Virginia and North Carolina to express this commitment directly to farmers.

Farmers are interested in continuation of the governmental tobacco program, guaranteed purchase at set levels of tobacco crops by cigarette companies, and some provision for buy out and transition to other crops, on a voluntary basis. Farm groups and tobacco state members have not yet coalesced around a consensus proposal. One plan put forward this month by Senators Ford and McConnell would require companies to buy a minimum amount of domestic tobacco over 25 years and would install penalties on companies that do not meet the stated goals for tobacco buying. The proposal would also create a "Tobacco Community Revitalization Fund" administered by USDA, but not subject to the appropriation process, which could spend up to $1 billion a year for 25 years from the settlement fund. This Revitalization Fund would cover costs related to the tobacco program such as administration and crop insurance, make supplemental payments of up to $500 million to producers whose income from tobacco drops substantially below the 1996 level, pay up to $100 million in benefits for displaced cigarette factory workers, and provide up to $250 million a year for rural economic development grants.

One possible way to address this issue is to secure an agreement from the cōmpanies to maintain current purchases of domestic leaf, even if domestic consumption declines. Because of GATT, Congress cannot require companies to purchase a set level of domestic tobacco. USDA believes, however, that a private contract between growers and the industry would not trigger a GATT violation.

Recommendation: Vow to protect tobacco farmers and communities in tobacco legislation.

I. International Issues

As you know, the settlement does not address international sale of tobacco products. Public health groups have criticized this aspect of the settlement; more broadly, they are pushing for the United States to take a leadership role in fighting tobacco's rapid global growth. Worldwide, there are 3 million tobacco-related deaths annually, and the World Health Organization expects that number to rise to 10 million by 2025, with 75% of annual deaths occurring in developing countries.

Some have suggested changes to normal trade policy as a response to the global spread of tobacco. USTR's current policy is to fight discriminatory barriers on behalf of all industries, including tobacco. One proposal is for USTR to stop providing such assistance to tobacco companies, on the ground that the entry of U.S. tobacco companies into foreign countries has arguably increased tobacco consumption. Your trade advisors, however, do not believe that we should take such action at this time.

As you noted just after announcement of the settlement, the United States can act by example in the area of tobacco control. That means, first and foremost, adopting policies to reduce smoking in <u>this</u> country. In addition, it means strengthening the Administration's leadership role in global and bilateral efforts to reduce smoking, including by providing assistance to international organizations. Finally, and at the very least, it means that U.S. embassies and missions act consistent with domestic policies by curtailing their involvement in tobacco marketing and export promotion activities. HHS is working with the Departments of State and Commerce on new guidelines on this issue.

Recommendation: Support efforts by other countries and international organizations to reduce smoking around the world.

J. Funding

Although the settlement is advertised at $368.5 billion, a variety of factors conspire to leave us with considerably less than that to spend on any new initiatives. The $368 billion is a 25-year number, and must be adjusted downward to reflect a projected drop in cigarette consumption of about 15%. For scoring purposes, OMB adjusts the amount down still further to reflect lost business tax revenue and lost federal excise tax revenue from decreased consumption. Most of the rest of the money in the settlement is already spoken for, to pay for civil suits, cessation programs, counteradvertising, and the states' Medicaid claims. No specific provision is made to reimburse the federal government for its Medicaid or Medicare expenses.

Options for How Much the Industry Should Pay

The attached charts outlines options on how much funding to seek and how to spend it. A chart attached to this memo suggests four options for how much the industry should pay:

1. **Current settlement:** This option assumes repeal of the $50 billion tax credit in the budget agreement, restoring gross industry payments to the original level negotiated by the attorneys general -- $368 billion over 25 years, with lookback penalties of up to $32 billion over that period. This option would raise cigarette prices by approximately 60 cents a pack (on top of the 15-cent increase in the budget agreement).

2. **Tough penalties:** This option assumes the full level of base payments in Option 1 ($368 billion), with dramatically tougher penalties on the industry if it fails to reduce teen smoking (which could raise up to $303 billion over 25 years). These penalties would include a company-by-company surcharge, as well as stiff penalties of up to $1 a pack. The entire option would raise cigarette prices between 60 cents and $1.60 a pack, depending on the industry's success in reducing teen smoking.

3. **Restore promised investment revenues:** This option assumes the amount of payments necessary to fund additional public health investments at a level that reflects what some supporters of the original settlement said would be available. Under this option, the industry would make gross payments of $620 billion over 25 years. This option includes the company-by-company surcharge, but not the steeper youth penalties. This option would raise

cigarette prices by $1 a pack.

4. $1.50 per pack: This option assumes the level of industry payments necessary to increase cigarette prices by $1.50 a pack right away, which David Kessler and Rep. Waxman have urged. Under this option, the industry would make gross payments of $943 billion over 25 years.

Ways to Spend Additional Funding

The current settlement would fund a variety of public health initiatives, including a counteradvertising campaign; smoking cessation programs; FDA enforcement; other tobacco control efforts; and a $4-billion-a-year trust fund that could serve as a 21st Century Research Fund dedicated to biomedical and tobacco-related research.

A chart attached to this memorandum outlines possible uses for additional funds, if any.

IV. STRATEGIC CONSIDERATIONS

Your announcement next week can be phrased either in terms of broad principles or in terms of concrete proposals. Some of your advisors believe that you should operate at a high level of generality. They argue that Congress is unlikely to take up tobacco legislation until next year; that the climate for anti-tobacco legislation is improving every day; and that in this context, there is a real danger of bidding too low. They assert that we cannot control the congressional debate (Congress will pick apart our proposal, as it will pick apart the settlement itself) and that saying too much now will decrease our leverage in the future. Other advisors favor a high level of specificity. They argue that the only way to get comprehensive tobacco legislation done right -- certainly this fall, but perhaps at any time -- is to tell Congress exactly what it should look like and then demand its passage. A specific proposal, in this view, will provide momentum and will orient the debate in our direction.

Another question concerns the way you talk about the proposed settlement. There are essentially three options here, irrespective of how you come out on any of the substantive issues in this memo. One rhetorical approach is to denounce the settlement as fundamentally flawed, to urge that it be discarded, and to propose an alternative. Another rhetorical approach is to endorse the framework of the settlement, though articulating certain modifications and strengthenings. A middle position is to laud the settlement for the progress it made and the significant opportunity it created, but to propose your <u>own</u> principles and plan for tobacco legislation. The more you embrace the settlement (even if only rhetorically), the more you take on the baggage it has accumulated during the past few months; on the other hand, the more you denounce the settlement (again, even if only rhetorically), the more you decrease the probability of expeditious congressional action.

Tobacco?

UNCLASSIFIED FAX FROM
THE NATIONAL ECONOMIC COUNCIL
AND
THE NATIONAL SECURITY COUNCIL OF
THE WHITE HOUSE

SENDER: **Sherman G. Boone** SGB

PH: 202-456-9288
FAX: 202-456-9280

PAGES: 5 **DATE:** September 26, 1997

SUBJECT: **Tobacco: International Issues Up-date**

TO:

Agency	Name	Phone #	Fax #
CEA	Chad Stone	395-5086	395-6958
	Carrie Thompson	395-3517	395-6853
DPC	Paul Weinstein	456-5577	456-7028
	Tom Freedman	456-5587	456-7431
	Mary L. Smith	456-5571	456-7431
OSTP	Jerry Mande	456-6018	456-6027
OVP	John Norris	456-9518	456-9500
OMB	Joe Minarik	395-5873	395-1198
USTR	Jennifer Haverkamp	395-7320	395-4579
	Jan McAlpine	395-9582	395-4579
HHS	Andy Hyman	690-6318	690-7998
HHS/CDC	Michael Eriksen	205-9235	205-8313
	Michelle Chang	205-9221	205-8313
HHS/FDA	Judith Wilkenfeld	301-827-0933	301-443-5169
	Linda Horton	301-827-3344	301-443-6906
HHS/OPHS	Ripley Forbes	260-2255	260-1570
State/OES	Nancy Carter-Foster	647-2435	736-7336
State/EB	Terry Miller	647-3090	647-2302
	Paul Aceto	647-1490	647-1894
USDA	Charlie Rawls	720-6158	720-5437
USDA/FAS	Lana Bennett	720-9519	690-1171
USDOC	Troy Cribb	482-3737	482-2331
	Les Simon	482-0341	482-3981
Treasury/OASIA	Bob Boorstin	622-0486	622-0073
	Whit Warthin	622-1733	622-1731
	Gene Clapp	622-1261	622-2505

There will be an inter-agency working group meeting on **Tuesday, September 30 at 3:30 pm in Room 231 of the OEOB** to discuss the international tobacco issues.

Attached is a revised draft of the proposed State/Commerce/Ag guidelines; this draft incorporates language from USTR's policy paper, as well as some of the ideas discussed at our September 2 meeting. It does not reflect possible policy changes that may be warranted, particularly in light of the amendment to the State-Commerce-Justice Appropriations Bill approved this morning. This amendment states:

> None of the funds provided by this Act shall be available to promote the sale or export of tobacco or tobacco products, or to seek the reduction or removal by any foreign country of restrictions on the marketing of tobacco or tobacco products, unless such restrictions are not applied equally to all tobacco and tobacco products."

In addition to trade policy and business facilitation issues, there will also be a discussion of possible new international public health and education initiatives pursuant to the President's statement of last week.

Please RSVP with the dates of birth and Social Security numbers of those attending (to fax # 456-5334) for clearance into OEOB. Thank you.

draft of 9/25/97

Tobacco: Guidance for U.S. Diplomatic Posts on Trade and Commercial Issues

The opening of international markets to U.S. products, national treatment for U.S. exporters, and removal of barriers to international trade are high priorities of the U.S. Government and the Clinton Administration. At the same time, given the recognition of the importance of health measures internationally, and the need to distinguish legitimate health-based actions from protectionism, the Clinton Administration is approaching the intersection between U.S. trade and health policies in a way which recognizes that insisting on non-discriminatory treatment of U.S. companies by our trading partners should not undermine other governments' genuine health-based policies.

Tobacco sits squarely in this intersection. In light of the serious health consequences of tobacco use, the U.S. Government and its officials will not support the activities of individuals or entities involved in the export, manufacture, promotion, distribution or sale of tobacco or tobacco products, or undertake any efforts that are likely to increase the overall demand for tobacco products. The USG respects the rights of foreign governments to establish and maintain sound public health practices, and encourages them to do so. On the other hand, the USG will continue to support activities to eliminate discriminatory practices and will seek "national treatment" in advocating U.S. industry interests: the overall objective is to shrink the global market for tobacco without disadvantaging U.S. firms.

Trade Policy Considerations

It is United States policy to treat as presumptively valid any foreign country's non-discriminatory health policy measures intended to reduce tobacco consumption, while reserving the right to object to such measures when they are discriminatory. This Administration will continue to ensure that the policies we pursue abroad are consistent with our own health policies and do not interfere with other countries' legitimate efforts to address health issues. Our trade negotiators will not seek to prevent foreign governments from taking steps to protect their citizens by adopting legitimate health measures to restrict the consumption of tobacco.

To this end, the Office of the United States Trade Representative (USTR) does not interfere with or object to foreign countries' adoption or enforcement of measures necessary to protect public health, including advertising and promotion restrictions; however, these restrictions should be applied in a non-discriminatory fashion. The requirement of non-discrimination is the cornerstone of the international trading system, as embodied in the Uruguay Round Agreements. Uruguay Round rules also provide ample scope for nations to pursue their own legitimate health policy objectives. The U.S. Government expects those trading partners exporting to the U.S. market to abide by the health-based requirements we place on our domestic industries. By the same token, we will respect other countries' legitimate health-based measures. However, such restrictions must be applied in a way that does not unjustifiably discriminate against U.S. products or otherwise amount to a disguised restriction on trade.

Commercial Policy Considerations

U.S. Government personnel should not be involved in the business of promoting the use of tobacco. Posts may assist U.S. tobacco companies with "responsive business facilitation" such as providing publicly-available business, market and regulatory information; assisting with problems such as shipments held at port, trademark violations, smuggled imports, or phytosantiary requirements; or assisting with industry/government contacts. Any assistance should not undermine nondiscriminatory health regulations. Although in the past, Post assistance may have extended beyond "responsive business facilitation," the serious health consequences associated with tobacco use require limitations.

Consistent with U.S. trade policy, Posts should not in any way challenge or interfere with host country regulations based on sound public health principles and following the principle of "national treatment," i.e. that are applied in a non-discriminatory manner to both imported and domestic tobacco products. Posts may, after consultations with State/Commerce/Agriculture and other relevant agencies, and in accordance with Trade Policy Coordinating Committee guidance and appropriate instructions, challenge unfair or discriminatory trade practices against U.S. tobacco firms or tobacco products. Posts may also seek clarification of regulations affecting U.S. tobacco firms or tobacco products and, after consultations and upon instructions, may challenge any lack of transparency in such regulations.

Post Guidelines

1. Posts should not challenge or interfere in any way with host country regulations based on sound public health principles, applied in a nondiscriminatory manner to both imported and domestic tobacco products, and for which sufficient notice has been given.

2. Posts may not assist or participate in promotional activities of individuals or entities involved in the export, manufacture, promotion, distribution or sale of tobacco or tobacco products that are likely to increase the overall demand for tobacco products. Posts should particularly avoid facilitating or associating with activities that utilize cartoon characters or other forms of non-text advertising or promotional materials for marketing and promotion, as these tend to target special populations, such as children.

3. Ambassadors or embassy staff may not, in their official capacity, attend receptions, trade promotions, or any events sponsored by individuals or entities involved in the export, manufacture, promotion, distribution or sale of tobacco or tobacco products where tobacco brand names will be featured.

4. Posts are encouraged to assist and promote tobacco-control efforts sponsored by host country health officials and other health agencies, including:

-- reporting on tobacco use trends in host countries, local and national ordinances and legislation, and other actions directed toward tobacco use prevention among children and youths;

-- advising national leaders of U.S. willingness to share information on harmful effects of tobacco use, and U.S. interest in the experiences of other countries;

-- participating in host country events that highlight tobacco use prevention and cessation;

-- advising USG agencies of opportunities for interaction with host country officials and scientists on tobacco issues; and

-- informing individuals or entities involved in the export, import, manufacturing, promotion, distribution or sale of tobacco or tobacco products of national and local laws and regulations pertaining to tobacco and tobacco products.

Sen. Feinstein Makes Appeal to Stop Assault Weapons Export to U.S. By Jeff Brazil and Steve Berry

Escalating her campaign against the importation of assault weapons, U.S. Sen. Dianne Feinstein Thursday appealed to the leaders of Russia, Greece and Bulgaria to prevent the export of thousands of the rapid-fire guns to the United States.

``These are exactly the kind of weapons many Americans are trying to keep off our streets," the California Democrat wrote in letters sent to Russian President Boris Yeltsin, Greek Prime Minister Konstandinos Simitis and Bulgarian Prime Minister Ivan Kostov.

The weapons in question are modified versions of the AK 47 and Heckler & Koch 91, which were first restricted by federal law in 1989 and again in 1994. The weapons have been cosmetically changed to comply with those legislative restrictions. But, according to Feinstein, these high-capacity, semiautomatic assault weapons still ``are not suitable or readily adaptable to sporting purposes," thus are in violation of the 1968 Gun Control Act, and should be barred from import.

Feinstein is asking the leaders to intervene because, in each case, the companies exporting the weapons to the United States are at least partially owned by the governments in those countries.

``What is becoming more evident is the fact that other countries are beginning to export various mutations, cosmetic mutations, of assault weapons, but the military, assault capability and capacity of the weapons are the same," Feinstein, a member of the Senate foreign relations committee, said Thursday.

The importation of the weapons at issue was approved by the U.S. Bureau of Alcohol, Tobacco and Firearms, which has said that it had no choice but to grant an import request if a weapon has been changed enough to comply with the 1994 federal assault weapons law. Feinstein, however, believes the agency is misinterpreting the 1968 Gun Control Act, which bars the import of even reconfigured assault weapons if they are not found to have legitimate ``sporting purposes."

``We're looking into the issues that the senator is presenting," Brian Burns, an ATF spokesperson, said.

Thursday's action comes a month after Feinstein asked Israeli Prime Minister Benjamin Netanyahu to block the proposed export to a U.S. gun manufacturer of tens of thousands of modified Uzi and Galil assault weapons a request the Israeli government is still considering.

The request also comes three weeks after Feinstein, joined by 29 other U.S. senators, urged President Clinton to suspend the importation of semi-automatic military-style assault weapons until it can be determined that the weapons are in compliance with U.S. law. Clinton has met with Feinstein, and his staff is said to be considering what action, if any, to take.

``The president ought to shut it down," Feinstein said Thursday.

Sentencing of Rep. Kim Is Postponed (Los Angeles)

LOS ANGELES A federal judge has postponed until Jan. 14 the sentencing of U.S. Rep. Jay C. Kim, R-Calif., and his wife, June, who pleaded guilty in August to misdemeanor charges of knowingly accepting and concealing more than $230,000 in illegal campaign contributions from corporate and foreign donors.

The Kims were to have been sentenced Oct. 23, but Judge Richard A. Paez granted a delay at the request of the federal probation office, which is preparing a pre-sentencing report on the couple for the court.

Under terms of a plea agreement with the Kims, the U.S. Attorney's office agreed to seek no more than six months jail time for them.

Tobacco Industry Slapped with Pair Massive New Lawsuits By Henry Wein.

EW

The tobacco industry encountered new legal problems two massive lawsuits seeking the recovery of billions of a treating sick smokers by federal Medicaid, Medicare and vet programs were filed in federal court in Wichita, Kan.

The suits were filed by individuals, acting on behalf of federal taxpayers.

The cases are analogous to those filed by 41 state attorneys general seeking recompense for expenditures the states made treating sick smokers. The suits allege that the cigarette companies have engaged in a conspiracy spanning more than four decades to deceive the public about the dangers of their products, hook teen-agers on an addictive product and keep them addicted by manipulating nicotine levels.

Consequently, the suits allege the U.S. government has incurred more than $100 billion in expenses treating smokers under various federal benefit programs.

Under terms of the proposed national tobacco settlement that would resolve the state cases and 17 major class actions, only state governments were to receive a portion of the $368.5 settlement fund, even though about half of the money spent on smoking-related illnesses by the states was provided to them by the federal government, said Mark D. Hutton, a Wichita attorney who represents the plaintiffs in the cases filed Thursday.

Since federal officials have not carried out ``their obligations to the taxpayers" to seek recovery of money to compensate the federal government for expenses incurred treating smoking-related diseases, ``our clients are doing it for them," said Hutton's co-counsel Gary L. Richardson of Tulsa, who was the U.S. attorney in Oklahoma in the early 1980s.

Because the tobacco settlement must be approved by Congress, there has been no determination of how the funds would be allocated if the deal is enacted into law. In theory, the federal government would be entitled to a healthy chunk in some cases up to 80 percent of any recovery a state got, depending on how much of a state's Medicaid money came from the U.S. treasury.

However, the attorneys general have been attempting to persuade lawmakers in Washington that they be permitted to keep all of the money so long as they allocate it for health care for uninsured children or a similar purpose.

Since the national settlement was announced on June 20, several lawmakers, led by Sen. Edward M. Kennedy, D-Mass., have said that there has to be reimbursement to federal taxpayers for any settlement to pass muster.

Just two days ago, the Department of Defense announced that the agency felt it was entitled to a substantial recovery if the settlement becomes law because the department spends $584 million a year to treat service personnel with illnesses caused by smoking.

Mississippi Attorney General Mike Moore, who filed the first of the state cases against the $50 billion-a-year tobacco industry, told senators this summer that some time ago he had formally asked the Justice Department to sue the cigarette companies, utilizing the same legal theories that the states had used. He said Justice Department officials never responded.

Justice officials had no immediate response Thursday to the new suits. Spokespersons for Philip Morris, Inc. and R.J. Reynolds Tobacco Corp., the nation's two largest cigarette makers, said they had not been served with the suits and thus could not comment.

OK, Tom

FYI

BR

to Blanche?

Clinton Taps 3 Lawyers To Fill NLRB Board, Help Reduce Backlog

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—President Clinton yesterday picked three labor lawyers to serve on the National Labor Relations Board.

The nominees are Wilma B. Liebman, deputy director of the Federal Mediation and Conciliation Service here; Peter J. Hurtgen, a law partner at Morgan, Lewis and Bockius in Miami; and Joseph Robert Brame, a law partner at McGuire, Woods, Battle and Boothe in Charlottesville, Va.

If all are confirmed by the Senate, the labor board would have a full complement of five members for the first time since August 1995. In fact, the board has been laboring with only three members – two of whom are presidential recess appointments—since February.

William B. Gould, the board's chairman, said the shorthandedness has helped create a serious case backlog. The NLRB is the independent agency that administers the nation's main labor law, the National Labor Relations Act.

Congress May Rescue Satellite Broadcasters From Royalty Boost

Dow Jones Newswires

WASHINGTON – Lawmakers may come to the rescue of the fledgling satellite broadcast industry after copyright officials agreed to quadruple the fees the companies must pay to carry network television programming.

Senate Commerce Committee Chairman John McCain (R., Ariz.) and others have complained that the higher royalty fees threaten the industry's push to compete for cable-television viewers. Congress has been keeping a close eye on rising cable-TV rates, and sees direct broadcast satellite services, or DBS, as a way to break cable-TV monopolies.

"This is a very troubling decision," said Rep. Billy Tauzin, the Louisiana Republican who chairs a House subcommittee on telecommunications. "Clearly, Congress is trying to open the door to competition, only to have that door slammed in our faces."

The higher rates are good news for television networks, Hollywood movie studios, sports leagues and other owners of television programming. But the rates will hurt companies such as EchoStar Communications Corp. and Hughes Electronics Corp.'s DirecTV, which must pay for rights to carry the programming. (Dow Jones & Co., publisher of The Wall Street Journal, is an investor in U.S. Satellite Broadcasting Co., a DBS service.)

The DBS companies said they will challenge the fee increase in court, while lawmakers vowed to explore legislative remedies.

Rates will rise to 27 cents a month per subscriber for network and superstation signals. Currently, DBS operators pay a per-signal charge ranging from six cents a subscriber for distant network signals to 17.5 cents for satellite superstations.

Bill Would Raise The Price of Pack Of Cigarettes $1.50

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON – Democratic Sen. Frank Lautenberg of New Jersey and Republican Rep. James Hansen of Utah introduced a bill to boost cigarette prices by $1.50 a pack within three years, raising an estimated $494 billion over 25 years for state and federal anti-smoking and public-health programs.

Public-health authorities generally concur that a cigarette-price increase of about $1.50 a pack could make a substantial dent in underage smoking. By some estimates, the proposed $368.5 billion national settlement negotiated by state attorneys general, public-health advocates and tobacco companies would raise prices by only 62 cents a pack; the companies contend that the actual increase, after wholesale and retail markups, would top $1.50.

President Clinton has proposed a combination of industry payments and penalties that could raise prices $1.50 a pack over 10 years. Many public-health groups, including a coalition formed to support the president's proposed changes in the settlement, also expressed support for the legislation.

Both the House and Senate bills would raise cigarette prices by 50 cents a year for the next three years and index future increases to inflation "to ensure that youth smoking does not rise again due to inflationary effects," Sen. Lautenberg's office said. It would distribute 75% of the proceeds, estimated at $15 billion a year, to states and 25%, estimated at $5 billion, to the federal government for a variety of anti-smoking programs.

Three Nominees to FCC Are Approved by Senate

Dow Jones Newswires

WASHINGTON – The Senate approved three of President Clinton's four nominees to the Federal Communications Commission last night.

The Senate by voice vote approved Michael Powell, Harold Furchtgott-Roth and Gloria Tristani to be commissioners. Today the Senate is expected to debate and vote on the nomination of William Kennard for FCC chairman.

Mr. Powell, the son of retired Army Gen. Colin Powell, is chief of staff of the Justice Department's antitrust division. Mr. Furchtgott-Roth is the House Commerce Committee's chief economist, and Ms. Tristani serves as commissioner of the New Mexico State Corporation Commission. Mr. Kennard is the FCC's general counsel.

To Vicki?

Jim –

could you get and distribute a section-by-section analysis of this bill? Thanks

Chris

PS – Also – could you get – the attorneys fee legislation?

239048

EW62878

tobacco

The Speaker
United States House of Representatives
Washington, D.C. 20515

Newt Gingrich
Sixth District
Georgia

October 3, 1997

President William Jefferson Clinton
The White House
Washington, DC 20500

Dear Mr. President:

I appreciate the time you spent with Members of Congress this week to discuss the many issues surrounding tobacco regulation. It was a productive meeting with many areas of agreement – such as a consensus that we must strongly focus on teen health. Given that consensus, I must register my profound disappointment that the nation's drug czar, Lt. General Barry McCaffrey, did not join us as an active participant. Focusing solely on tobacco – at a time when children of increasingly younger ages are experimenting with a variety of legal and illegal substances – sends a mixed message with potentially fatal consequences.

Any anti-tobacco campaign must be placed in the broader framework of a comprehensive anti-addiction approach. We don't want to end up with young people thinking it's all right to do crack or cocaine or heroin or marijuana as long as they don't smoke tobacco. Thus, it's very important that General McCaffrey be fully involved in helping us design a complete anti-addiction program, not just a narrowly-focused initiative that might have unforeseen effects.

Similarly, allow me to suggest that Vice President Gore's upcoming regional meetings focus broadly on the impact of various addictions on our children's health and what steps are needed to protect children in the future.

I believe, as I'm sure you do, that it is important for our nation's leaders to speak clearly and with one voice when it comes to safeguarding our children's future.

Sincerely,

Newt

Newt Gingrich

EW

BR - FYI.
(1) memo on tobacco smuggling
(2) NYT - p.A1 story on same
(3) memo we got from
a) Custom's
b) ATF
On same subject
Tom

MEMORANDUM

TO: ELENA KAGAN

CC: JERRY MANDE

FROM: TOM FREEDMAN, MARY L. SMITH

RE: TOBACCO SMUGGLING

DATE: AUGUST 25, 1997

Tom —
Are we doing anything more on this?

File: Tobacco-Smuggling

SUMMARY

Cigarette smuggling to other countries has almost tripled in the last few years up to 280 billion cigarettes a year. Smuggling increases have correlated to increases in duties and taxes imposed on foreign cigarettes. Tobacco companies have a role in cigarette smuggling in that they sell to traders and dealers who, in turn, funnel the cigarettes to smugglers. There are criminal cases currently pending in Spain, China, Canada, and the United States. Two Brown & Williamson sales managers have recently pleaded guilty to federal charges of aiding smugglers.

The recent upsurge in smuggling could have impacts on the proposed settlement with the tobacco companies, specifically with respect to the FDA regulation of nicotine in that the settlement, as written, requires the FDA to prove that a change in the level of nicotine or other harmful components "will not result in the creation of a significant demand for contraband." Because the levels of contraband in other countries is already so high, by requiring the FDA to prove a negative, the settlement sets up an extremely high standard. In addition, given the experience of other countries that have raised cigarette prices, the proposed settlement might open the door to increased smuggling in the United States.

Other than its involvement in the specific cases mentioned in this memo in Syracuse and New Orleans, DOJ reports that it does not have a nationwide, coordinated effort or task force to combat smuggling.

FACTS ON SMUGGLING

- The volume of cigarette smuggling around the world has nearly tripled.
- Researchers estimate that one-fourth of the cigarettes sold overseas pass through smuggling rings set up to evade foreign taxes.
- Criminal investigations in several countries show that people in the tobacco industry have played a major role in stimulating and facilitating the smuggling of cigarettes. The most

common way in which cigarette companies play a role is that each year they sell billions of dollars of cigarettes to traders and dealers who, in turn, funnel the cigarettes to smugglers.

RECENT CRIMINAL INVESTIGATIONS

1. Canada

- Newly released court documents in Syracuse show that R.J. Reynolds Tobacco Company, the second-largest American cigarette maker, sponsored trips to a luxury Canadian fishing resort for several dealers who have subsequently been charged with conspiring to smuggle cigarettes to Canada. On one fishing trip in 1995, one Reynolds salesman, Les Thompson, even joked to the dealers about the smuggling, implicitly acknowledging that he had knowledge of it.

- One informant said it was clear that Mr. Thompson from Reynolds knew that the dealers were selling to cigarettes to American Indians who smuggled them across the St. Lawrence River.

- The investigation involving R.J. Reynolds is centered in Syracuse and Canada. In June, a grand jury in Syracuse indicted 21 people on charges that they were involved in smuggling $700 million worth of cigarettes and alcohol through the St. Regis Indian Reservation in upstate New York from 1992 through 1996.

- In another investigation in New Orleans, two Brown & Williamson sales managers have recently pleaded guilty to charges of aiding smugglers in bringing cigarettes illegally into Canada.

2. Spain

- One of Europe's biggest cigarette traders, Michael Hanggi, admits that he had been buying Winstons from R.J. Reynolds for 15 years and had resold many of them in Spain.

- Mr. Hanggi said that his three-person trading company in Switzerland had handled $100 million in sales last year.

- Authorities estimate that last year that 2.3 billion Winstons made by R.J. Reynolds, or $200 million worth, were smuggled into Spain.

- Investigators found a series of faxes showing that for years Reynolds officials in Geneva kept track of the volume of cigarettes that were supposedly being shipped to Senegal in West Africa but instead were illegally diverted to Spain. Given that all the shipments were diverted to Spain, the figures could not possibly have matched Reynold's sales reports from Senegal. In fact, USDA figures show that Senegal imports no more than 500 million cigarettes a year -- less than one-fourth of the amount diverted to Spain.

3. **Italy**

- Two organized crime groups in Italy take in $500 million per year by smuggling Malboros they buy from Swiss dealers selling products made by the Philip Morris Companies, the largest cigarette maker in America.

4. **China and Hong Kong**

- Later this year, Hong Kong prosecutors plan to place a former marketing manager for the British-American Tobacco Corporation, a subsidiary of B.A.T. Industries and a British affiliate of Brown & Williamson, on trial on charges that he accepted more than $3 million in bribes from dealers involved in smuggling cigarettes into China.

- Smuggling accounts for 4 to 5 percent of the cigarettes sold in China. But the market is so vast that this amounts to 70 billion to 85 billion cigarettes a year.

QUESTIONS AND ANSWERS

Q: **What is the scope of the smuggling?**

- Market Tracking International Ltd., a research firm in London that provides data to tobacco industry publications, estimates that 280 billion of the 1 trillion cigarettes exported each year by all producing nations pass through the hands of smugglers, up from 100 billion in 1989.

- In Spain, Winston, manufactured by R.J. Reynolds, is the most popular foreign brand, and last year 60 percent of its sales were contraband. The smugglers can sell a pack of contraband Winstons for $1.30 to $1.60, about the same price as a local brand and one-third less than the price of legal Winstons.

Q: **What are the causes of the recent surge in smuggling?**

- There are many causes from the relaxation of customs inspections in Europe to the opening of markets in Russia and Eastern Europe. The surge is also attributable to the expansion of sales overseas by American tobacco companies. High taxes, limits on imports, and corrupt distribution systems also help account for the increase in cigarette smuggling.

Q: What have the cigarette companies said?

- Spokespersons for the three cigarette companies, R.J. Reynolds, Philip Morris, and Brown & Williamson, publicly maintain that they did not knowingly sell to dealers who supplied to smugglers. The companies urge that their executives did not do anything wrong and that they should not be held accountable for illegal activity that occurred after they sold their product. However, some of the evidence in criminal cases in Spain, Canada, and China indicates that the companies did have some knowledge. For instance, R.J. Reynolds kept track of the shipments of cigarettes allegedly destined for Senegal but that were instead diverted to Spain.

Q: How much does the smuggling cost?

- The smuggling costs foreign governments an estimated $16 billion a year in lost revenues. But more important, health experts say it threatens to undermine initiatives in many nations to discourage smoking, particularly among teenagers.

Q: What is the potential impact for the settlement?

- **FDA authority to regulate nicotine.** The proposed agreement says that before the FDA could order the companies to lower the nicotine in cigarettes, it would have to guarantee that smugglers would not bring in more potent substitutes. But given how easily smuggling can take place, the President said last month that this provision was unreasonable and should be changed. Specifically, the settlement provides that the FDA shall be permitted to require the gradual reduction of nicotine and the possible elimination of other harmful components of tobacco products, provided it can demonstrate that the changes: (1) will result in a significant reduction of the health risks associated with such products; (2) are technologically feasible; and (3) will not result in the creation of a significant demand for contraband or other tobacco products.

- **Raising prices could lead to smuggling in U.S.** There is a potential that raising prices in the U.S. could cause an increase of smuggling in American brands manufactured elsewhere.

- **Increased smuggling worldwide.** With the restrictions imposed on the tobacco companies in the proposed settlement, the tobacco companies are expected to step up their efforts to expand their markets in other countries. With sales expected to decrease in the U.S. as the result of the settlement, there could be an even greater increase in smuggling worldwide.

- **Tobacco companies' attitudes and cooperation with investigators.** Tobacco companies have demonstrated that they are not willing to try to stop smuggling. In fact, investigators in Europe stated that tobacco company officials hide behind Swiss law which basically does not view smuggling as a crime and contains provisions on secrecy in commercial transactions.

Cigarette Makers Are Seen As Aiding Rise in Smuggling

Tobacco Giants Deny Role in Illegal Trade; Inquiries Show There May Be One

A1

By RAYMOND BONNER and CHRISTOPHER DREW

The largest tobacco companies are selling billions of dollars of cigarettes each year to traders and dealers who funnel them into black markets in many countries, say law enforcement officials and participants in the trade.

In the last decade, the volume of cigarette smuggling around the world has nearly tripled, according to a leading tobacco research organization. This reflects a general surge in cigarette sales abroad, especially for American brands. And industry officials acknowledge that a sizable share — the researchers say one-fourth — of the cigarettes sold overseas pass through smuggling rings set up to evade foreign taxes and sell major brands at a discount.

The companies say they do nothing to encourage the smuggling and do not condone it. But recent criminal investigations in several countries show that people in the tobacco industry have played a significant role at times in stimulating and fueling it.

In one case, two sales managers for the Brown & Williamson Tobacco Corporation have pleaded guilty to aiding smugglers. But what law enforcement agents say is far more common is for the companies to sell huge quantities of top brands to traders and dealers who are little more than pipelines to the smugglers.

For instance, newly released court documents show that the R. J. Reynolds Tobacco Company, the second-largest American cigarette maker, sponsored trips to a luxury Canadian fishing resort for several dealers who have since been charged with conspiring to smuggle cigarettes into Canada. On one fishing trip in 1995, a Reynolds salesman even joked with the dealers about the smuggling.

And some of the dealers admit that they pour huge volumes of cigarettes right into the smuggling networks.

One of Europe's biggest cigarette traders, Michael Hänggi, said in an interview that he had been buying Winstons from Reynolds for 15 years and had resold many of them to smugglers in Spain. Mr. Hänggi said his three-person trading company in Switzerland had handled $100 million in sales last year. "Of course I know where the cigarettes are going," he said. "But is that my problem?"

Other inquiries show that two organized crime groups in Italy take in $500 million a year by smuggling in Marlboros they buy from Swiss dealers selling products made by the Philip Morris Companies, America's largest cigarette maker. And later

Continued on Page D12

Continued From Page A1

this year, Hong Kong prosecutors plan to place a former marketing manager for the British-American Tobacco Corporation, a subsidiary of B.A.T. Industries and a British affiliate of Brown & Williamson, on trial on charges that he took more than $3 million in bribes from dealers involved in smuggling cigarettes into China.

Spokesmen for the three cigarette companies said they did not knowingly sell to dealers who supplied smugglers. They declined to discuss any of the criminal cases. But they said that while a few salesmen might have been too aggressive, their executives had done nothing wrong and that the companies should not be held accountable for what happened once they sold their products.

The smuggling costs foreign governments an estimated $16 billion a year in lost revenue. But more important, health experts say it threatens to undermine initiatives in many nations to discourage smoking, particularly among teen-agers.

That is because young people tend to smoke more when they can buy cigarettes cheaply, and smuggled brands often sell for about a third less than ones on which taxes and customs duties have been paid.

The sheer scope of the smuggling also could force changes in the $368.5 billion settlement being negotiated with the American tobacco industry. The proposed agreement says that before the Government could order the companies to lower the nicotine in cigarettes, it would have to guarantee that smugglers would not bring in more potent substitutes. But given how easily smuggling can take place, President Clinton said last month that this provision was unreasonable and should be changed.

The recent surge in black-market sales has many causes, from the relaxation of customs inspections in Europe to the opening of vast new markets in Russia and Eastern Europe. Market Tracking International Ltd., a research firm in London that provides data to tobacco industry publications, estimates that 280 billion of the 1 trillion cigarettes exported each year by all producing nations pass through the hands of smugglers, up from 100 billion in 1989.

The rise in smuggling also has coincided with a huge push by the American companies to expand overseas, which they see as a way to offset a decline in sales at home. American cigarettes are regarded as top quality and are seen as chic in many countries.

But as popular as American and other Western brands are, the companies also run into various sales barriers, including high taxes, limits on imports and countries where cigarette distribution is corrupt.

The smugglers, though, have increasingly maneuvered around such limits.

To be sure, in cities from Naples to Bogotá, Colombia, the image of street peddlers hawking contraband cigarettes has been an enduring one.

The manufacturers benefit in that they normally receive the same price for cigarettes whether they end up in contraband markets or not. And despite markups by dealers, smugglers and salespeople, contraband cigarettes can still be sold cheaply and profitably because the savings from evading taxes can be so great.

Law enforcement officials say that the dealers usually provide such a distance between the companies and the smugglers that it would be hard to consider charging the companies with doing anything illegal. Yet even some dealers say that they and the companies sell the cigarettes so indiscriminately that they both know certain sales are headed for the black market.

If the companies say they do not, "It's a lie," said Corrado Bianchi, who said he had sold Philip Morris cigarettes as a dealer in Switzerland before retiring two years ago. "Of course they know."

Mr. Bianchi said he had sold large quantities of Philip Morris brands "to 200 people maybe, and they come from all over: Dutch people, Germans, Spanish, Greeks, Italians." But, he said, he never asked the buyers what they were going to do with the cigarettes. "In our work, you can't ask what they do with the cigarettes."

One result is that Mr. Bianchi ended up selling Philip Morris products to an organized crime figure now on trial in Italy, prosecutors there say. Mr. Bianchi himself is not a defendant, and he denied that he did anything wrong.

Andre Reiman, a senior vice president for a Philip Morris subsidiary in Europe, questioned whether the company had sold cigarettes directly to Mr. Bianchi. "As far as we can determine, he has never been a customer," Mr. Reiman said.

He added: "I am not going to sit here and tell you there is not contraband in cigarettes. It's there. The causes are just a little more complicated than people believe."

Philip Morris officials in New York said smugglers also competed with the company's distribution system and had jeopardized its investments in overseas factories.

Adam Bryan-Brown, a spokesman for Reynolds' international tobacco subsidiary in Geneva, said governments were responsible. "The root causes of contraband are well known — the high duties and taxes imposed on cigarettes," he said.

But Per Brix Knudsen, the director of an antifraud unit for the European Union, said: "It's astonishing that these big producers are not more concerned that such a large quantity of their product is arriving on the illegal market. How is it that such a trade can take place?"

Smuggling by Sea

Cargo Goes to Spain Instead of Africa

When the Wendy I, a huge cargo ship, edged out to sea from a port near Antwerp, Belgium, late last year, it was loaded with 16,000 cases of Winstons, or 160 million cigarettes. R. J. Reynolds, a subsidiary of the RJR Nabisco Corporation, had made them in the United States and shipped them to a warehouse in Antwerp. And its Swiss subsidiary sold them to a company owned by Mr. Hänggi, the Swiss trader.

Mr. Hänggi said he then sold the shipment to a Panamanian company and told a warehouse worker to indicate on shipping documents that the Wendy was going to Senegal in West Africa. But it would go no farther than Spain, where the cigarettes would bring up to $15.5 million on the black market. And this was just the start of a rich tale of intrigue that shows how sophisticated the smuggling networks have become and how hard they are to stamp out.

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The New York Times

MONDAY, AUGUST 25, 1997

The stage was set in Antwerp because it is one of the main distribution hubs for American cigarettes. Vast quantities pass through the port on their way to Russia and other places. Some of the cigarettes stay in legitimate hands; others shift course.

Mr. Knudsen and other authorities described Mr. Hänggi, 48, as one of Europe's largest and most brazen suppliers of cigarettes to smugglers. And before Spanish police seized the Wendy in January, they said, it was part of a long-running operation that last year smuggled 2.3 billion Winstons — $200 million worth — into Spain.

Investigators said the Wendy and other ships typically stopped in international waters well beyond Spain's 12-mile limit to minimize risks. There they transferred their loads to a high-speed torpedo boat once used by the German Navy, which took the cargoes close to the 12-mile mark. Then another set of boats would rush the cigarettes to shore.

When investigators began to piece together what had happened, they found some tantalizing evidence at the Belgian warehouse — a series of faxes showing that for years Reynolds officials in Geneva kept track of the volume of cigarettes that Mr. Hänggi supposedly was shipping to Senegal.

Given that all the shipments were diverted to Spain, the figures could not possibly have matched Reynolds's sales reports from Dakar, the capital of Senegal, investigators said. In fact, United States Agriculture Department figures show that Senegal imports no more than 500 million cigarettes a year — less than one-fourth of what was unloaded from the ships that Mr. Hänggi dispatched to waters off Spain in 1996.

Referring to Reynolds officials, Carlos Castresana Fernández, a prosecutor in the Wendy case, said, "The amount is so high, they can't say they don't know."

Neither Mr. Hänggi nor Reynolds has been charged with any wrongdoing. Reynolds would not discuss the Wendy case or confirm that Mr. Hänggi was a customer.

But in an interview at a yacht club on Lake Geneva in Switzerland, the irrepressible Mr. Hänggi acknowledged that he had been buying from Reynolds and reselling to smugglers for 15 years — and insisted he had done nothing illegal.

Yes, he said, he had bought the cigarettes that were on the Wendy from Reynolds. Mr. Hänggi, who is struggling to break a three- to four-pack-a-day habit with antismoking patches, said he then shuffled ownership through three of his companies. Investigators suspect this was to mask the trail, though Mr. Hänggi says it was to reduce Swiss taxes.

He also said that he sold the cigarettes to the Panamanian company before they left the warehouse, and he maintained that he was no longer legally responsible after that.

Still, Mr. Hänggi, who got into the tobacco industry as an apprentice when he was 15, remained involved, shepherding the shipment on the Panamanian company's behalf.

He had workers at the Belgium warehouse remove labels specifying where the Winstons were made. He also said he had dispatched the one-time torpedo boat to meet up with the Wendy off Spain.

Why were the labels removed from the cases? That is what the Panamanian client wanted, Mr. Hänggi said.

Who was that client? He said he could not remember the company's name.

Mr. Hänggi also was coy about what Reynolds knew about where the shipments were going. He shrugged, grinned and said, "I cannot speak for the companies."

Mr. Hänggi also said the cigarette companies' motives for selling to middlemen like him were clear: to bolster sales in countries like Spain and Italy where American cigarettes normally cost much more than local brands produced by state-run monopolies.

In Spain, for instance, Winston is the most popular foreign brand, and last year 60 percent of its sales were contraband, industry officials there said. The smugglers can sell a pack of contraband Winstons for $1.30 to $1.60, about the same price as a local brand and one-third less than the price of legal Winstons.

For the investigators, it is one thing to know that Mr. Hänggi and others are dealing so openly with smugglers, and it is another thing to stop it.

Mr. Hänggi, a Swiss citizen who once worked in Spain, runs his cluster of trading companies from Switzerland, in a small office above a grocery and a dress shop in the tree-lined village of Muttenz, near Basel.

Much of Europe's tobacco trade takes place in Switzerland, where Philip Morris and Reynolds have their European headquarters. Swiss law basically does not view selling cigarettes to people who smuggle them into another country as a crime. Investigators throughout the rest of Europe say that Swiss authorities — and the tobacco companies themselves — are rarely willing to cooperate.

Mr. Knudsen of the European Union said that when his investigators posed questions to Reynolds officials, they responded: " 'We'd like to help you, but Swiss legislation on commercial secrecy prevents us.' So they have provided nothing."

In the Wendy case, the investigators still have not figured out who owned the company in Panama that bought the shipment from Mr. Hänggi. And Mr. Castresana, the prosecutor, said it seemed unlikely that he would get to the bottom of what happened.

The seizing of the Wendy did force the smugglers to suspend the sea operations. But they quickly turned to the air.

Early this year, a jet flew from Ukraine to Belgium, where it picked up 20 million Winstons supposedly meant for North Africa. The plane then flew to two other countries before landing in the Basque region of Spain, where the crew produced documents saying it was carrying auto parts.

Over six weeks, the plane made 11 such trips, hauling a total of 220 million cigarettes, until Spanish police seized it. Investigators do not know who sold the cigarettes to the smugglers.

"I did, of course," Mr. Hänggi said.

He said a company registered in Aruba bought the cigarettes. Did he know the crew was going to smuggle the cigarettes into Spain? He laughed. "No, I thought they were going to smoke them."

Assault on Canada

Higher Taxes Set Off A Lucrative Trade

It was a rainy day at a salmon-fishing resort in British Columbia in September 1995. Les Thompson, an R. J. Reynolds salesman, was sitting around a fireplace with some of his customers.

Unbeknownst to Mr. Thompson, one man was an American informant. And according to court records unsealed in Syracuse on Aug. 13, he later described to a grand jury how the conversation took an intriguing turn — right into a discussion about smuggling cigarettes into Canada.

The New York Times
MONDAY, AUGUST 25, 1997

One document — an affidavit from a Federal law enforcement officer — quoted the informant as saying it was clear Mr. Thompson knew the dealers were selling the cigarettes to American Indians who smuggled them across the St. Lawrence River.

The informant said Mr. Thompson chided the dealers that if they did not keep better sales records, he would start selling directly to the Indians. And on another day when one g [illegible] fell ill on a fishing boat, Mr. Thompson joked that the man "should be used to the water from hauling the cigarettes," the affidavit said.

As raw as it might seem, industry critics and law enforcement officials say this episode was just the latest in a chain of evidence that the tobacco industry fueled a smuggling assault on Canada in the early 1990's.

The smuggling took off after Canada raised taxes several times largely to discourage cigarette consumption, one of the first countries to try this approach. Beginning in 1982, its taxes became increasingly stiffer. By 1992 a pack cost about $4.50 (United States) in Canada, compared with slightly less than $2 in the United States, making the situation ripe for smuggling.

Canadian health researchers think consumption did fall because of the taxes. And Canada's top three tobacco companies — each affiliated with either Philip Morris, Reynolds or B.A.T. — lobbied to repeal them.

The taxes did not apply to exports, and the companies started shipping large amounts of Canadian brands, like Players and Export A, to the United States even though few Americans smoke them.

Where once only a tiny portion of the cigarettes made in Canada had been exported, that total jumped to a third by 1993, with the bulk going to upstate New York and other border locales. Reynolds also began making Canadian brands in the United States and shipping them to dealers in border states. Most quickly found their way back into Canada through smugglers.

None of this was any secret in Canada. The industry "absolutely" knew that most of the exports were being smuggled back, Michel Descôteaux, a spokesman for Imperial Tobacco Ltd., which is partly owned by B.A.T., said in an interview.

But Mr. Descôteaux said this was not the industry's fault. "We had warned the Government for years that when the taxes were increased, there would be smuggling." He also said Imperial was simply "shipping cigarettes in response to orders" by American dealers. "What would you have us do?"

Still, by February 1994, the smuggling had become so intense that Prime Minister Jean Chrétien was forced to start rolling back the taxes. "The fact is," he said then, "that the Canadian tobacco manufacturers have benefited directly from this illegal trade." He said they had "known perfectly well" what was happening and added, "I believe they have not acted responsibly."

Since then, two criminal cases have reinforced what he said.

Federal undercover agents in New Orleans recorded talks with two Brown & Williamson sales managers in 1994 as they arranged shipments of Imperial products that were supposed to go to fishing vessels but were really smuggled back into Canada. Both men have since pleaded guilty to Federal charges of aiding smugglers.

Court documents show that one of them, Michael I. Bernstein, told an undercover agent that a sales official at Imperial had agreed to supply cigarettes for the smuggling as long as each order was kept small.

The documents quote Mr. Bernstein as saying the Imperial official would "go along with that." But, Mr. Bernstein cautioned, "he assured me that if and when we get snagged with the packet of stuff anywhere in Canada, they're going to cut me off."

Mr. Bernstein also told investigators that selling to smugglers was part of Brown & Williamson's marketing strategy. Brown & Williamson and Imperial officials have denied this, and Federal prosecutors recently closed the case without bringing additional charges.

The second investigation, centered in Syracuse and in Canada, is now raising similar questions about Reynolds.

The grand jury in Syracuse indicted 21 people in June on charges that they were involved in smuggling $700 million worth of cigarettes and alcohol through the St. Regis Indian Reservation in upstate New York from 1992 through 1996. Court documents state that some dealers regularly bought cigarettes from Reynolds and resold them — usually for cash — to members of an Indian tribe, who slipped them into Canada.

Affidavits by investigators in both countries show that Reynolds routinely entertained the dealers at the Sonora Island Resort in British Columbia, where the company sponsored an annual fishing tournament. One dealer told an informant last summer that he was about to take 12 to 14 associates to the tournament and that Reynolds was going to pay a $10,000 entry fee for each of them.

Reynolds says it does not condone smuggling and would not comment on the investigation. Mr. Thompson did not return calls for comment.

But David T. Sweanor, an antismoking advocate in Canada, said the industry "basically played Canada for a banana republic and got rewarded for it."

China Connection

Tobacco Floods Into Next Frontier

Tommy Chui's body was found floating in Singapore Bay on April 1, 1995.

Mr. Chui had been a cigarette dealer in Hong Kong, and had made sensational accusations about corrupt dealings there. These were the highlights: From 1986 through 1993, Mr. Chui's firm bribed a succession of B.A.T. marketing managers in Hong Kong to insure a steady supply of cigarettes. It resold most of them to smugglers running them into China, and the profits were so large that organized crime had muscled in.

Prosecutors in Hong Kong have charged Jerry Lui, who was B.A.T.'s commercial director there from 1991 to 1993, with taking more than $3 million in bribes from Mr. Chui's company. Mr. Lui has denied the charges, and B.A.T. executives have dismissed the whole affair as the work of rogue employees.

But there is no question that the smuggling has given B.A.T. a foothold in China, the most prized cigarette market. One-third of all the cigarettes in the world are consumed there. And the tobacco industry views China as its ultimate salvation.

So far, however, China has not played along. It wants to protect its state-run tobacco company, a major source of Government revenue. Chinese officials also have voiced concern about the health problems that could follow a marketing assault. And China has allowed foreign companies to form only limited ventures with its company.

So inevitably, smuggling is flourishing there. Industry analysts say it accounts for 4 percent to 5 percent of the cigarettes sold in China. But the market is so vast that this amounts to 70 billion to 85 billion cigarettes a year. And B.A.T. accounts for half of that.

China also seems bewildered by how to stop the smuggling. China's customs agency seizes only a tiny fraction of the contraband, and it has almost never prosecuted any of the big operators behind it.

So if the smuggling remains unchecked, China and the developing world will "really be bearing the brunt of it," said Judith Mackay, an antismoking advocate in Hong Kong. And while the tobacco companies have pledged to reduce smoking by teenagers in the United States, she said, the flood of smuggled cigarettes will only increase smoking by young people in other countries.

The New York Times
MONDAY, AUGUST 25, 1997

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EFFORTS BY THE UNITED STATES CUSTOMS SERVICE TO COMBAT THE SMUGGLING OF CIGARETTES.

BACKGROUND

The United States Customs Service is the primary agency combating the smuggling of prohibited items into and out of the United States. One such item is contraband cigarettes. Presently, there are very few restrictions as to the amount of cigarettes that may be exported or sold domestically. As a result, many U.S.-made cigarettes are sold to U.S. exporters who sell the cigarettes to tobacco traders in foreign countries. Many of these sales are legitimate and the foreign countries involved are collecting the duties owed them. Due to high excise taxes and import quotas, however, many known cigarette traders sell their cigarettes on the black market for a fraction of the cost of retail cigarettes or smuggle them to other foreign countries. In so doing, cigarette smugglers are reaping huge profits.

This type of criminal activity has had some negative effects outside of U.S. borders. The taxes imposed on cigarettes in foreign countries are a great source of revenue. As more cigarettes are sold on the black market, tax revenues decrease. As the price of cigarettes decrease, moreover, more people are likely to smoke since the price is no longer a factor. This in turn will increase the financial burden on the health systems in those countries.

The Customs Service stepped up its efforts to combat smuggling on both a domestic and international level. On a domestic level, the presence of Customs at the ports of entry has increased in an overall effort to strengthen border interdiction. One residual effect of this fortification should be an enhanced ability to combat cigarette smuggling. In addition, the problem of cigarette smuggling has been brought to the attention of Customs personnel and the Department of Justice.

DOMESTIC EFFORTS

On June 23, 1997, 11 individuals were arrested as a result of a joint enforcement action executed by the Customs' Buffalo field office as part of a federal task force. Those participating in the arrests were the BATF, the IRS, the INS, New York State Police, the US Attorney's Office and the Royal Canadian Mounted Police (RCMP). This investigation, the subsequent initiation of the federal task force, and the formation of a special federal grand jury were predicated upon information developed by Customs' Resident Agent in Charge, Rouses Point, New York.

The resulting enforcement action stemmed from an indictment returned in the Northern District of New York charging 21 individuals with the following charges: money laundering; smuggling; conspiracy; wire and mail fraud; RICO; and unlawful introduction of liquor into Indian country. The indictment is a result of a two and one-half year joint investigation into the alleged money laundering activities of the Larry Miller organization and the Akwesasne Indian reservation. According to information received, Miller's organization allegedly diverted cigarettes and liquor to Canada through the Akwesasne Indian reservation and then illegally transported unreported Canadian currency back into the US. During the course of the investigation, the Miller organization is alleged to have laundered over $500 million. It is also believed that Miller invested heavily in Russian casinos and has ties to Russian organized crime. The indictment also seeks forfeiture of $478,061,239 as well as substitute assets acquired by the defendants. In addition, seizure warrants were issued for ninety-nine vehicles, boats, snowmobiles, and other mobile conveyances. Also, Lis Pendens were filed against twenty-six real properties valued at approximately $4 million. The investigation is continuing and additional arrests are expected.

In another case in which four defendants recently were sentenced, a shipment of 150 cases of Canadian manufactured cigarettes was seized in Louisiana by Customs in 1993. According to the information received, the cigarettes were destined for Canada in violation of U.S. Customs law. The investigation revealed that the cigarettes entered the U.S. from Canada and were being smuggled back into Canada in an attempt to circumvent Canadian excises taxes. This long-term cigarette smuggling investigation resulted in the sentencing, on July 30, 1997, of four defendants involved with the Brown and Williamson Tobacco Corporation. The investigation is continuing.

INTERNATIONAL EFFORTS

On an international level, there has been an increase in cooperation between the U.S. and foreign governments through more effective communication, as well as through the execution of additional Customs Mutual Assistance Agreements. The Office of Foreign Operations at Customs Headquarters has contacted the appropriate foreign attaches in an effort to further assist our foreign counterparts. Among the countries that have expressed an interest are France, Italy, Germany, and the Newly Independent States of the former Soviet Union.

Customs has and will continue to assist other countries on this matter. As a result of heightened cooperation between the Customs Service and foreign governments, a number of cooperative investigations have been initiated with our foreign attaches. Through continued dialogue and training of foreign law enforcement officers, foreign countries presumably will be better equipped to identify smuggling patterns and activity. More importantly, it is hoped that foreign law enforcement agencies identify the means by which these criminal enterprises launder their ill gotten gains.

BRIEFING PAPER
DIVERSION BRANCH
AUGUST 26, 1997

Criminal tobacco trafficking usually occurs when foreign governments or state governments impose a higher excise tax on tobacco products than found in surrounding jurisdictions. These tax disparities lead to large-scale tobacco (cigarette) diversion from a lawful to an unlawful destination, thus defrauding the state or foreign governments of their due revenue.

There has been an over 500% increase from 1992 to present in the number of contraband cigarette trafficking tobacco investigations that ATF is conducting. The recent rise in trafficking is attributable to a number of factors, most notably a significant increase in both Canadian federal and provincial tobacco taxes in the late 1980s/early 1990s and an increase in certain states' cigarette taxes. Intelligence has determined that there exists a network of traditional and nontraditional organized crime groups operating transnationally. ATF is working approximately 65 investigations involving Canadian/U.S. and Mexican/U.S. cigarette trafficking, low-state-to-high-state trafficking, and Native American illegal sales.

Canada's initial tax increase was an attempt to generate health care revenue and to decrease cigarette consumption. The criminal diversion of tobacco products into Canada evolved from small, individual smuggling activities into sophisticated criminal enterprises. Canadian/U.S. criminal organizations have defrauded the Canadian government of between one and two billion dollars in revenue per year. ATF, IRS, US Customs and other Federal agencies recently indicted 21 individuals allegedly involved in Canadian/U.S. alcohol/tobacco trafficking to Canada. Assets from this illegal activity are estimated at over $500 million. In a similar scenario, higher state taxes in the Southwest has brought about U.S./Mexican diversion involving U.S. cigarettes "for export only." Export cigarettes are exempt from Federal taxes.

In the low-state-to-high-state trafficking, Michigan shows the greatest loss of state revenue with a conservative estimate of $75 million per year. Michigan has the third highest cigarette taxes in the U.S. Michigan traffickers obtain illegal cigarettes from wholesalers and retailers located throughout the South, where tobacco is traditionally taxed at a lower rate.

ATF is also working in conjunction with state revenue and law enforcement authorities investigating illegal Native American cigarette sales to non-Native Americans. Native American cigarette tax structure varies by state although the supplier of cigarettes involved in the trafficking have been from out-of-state wholesalers. Smoke shops making illegal tax-free sales in New York, Oklahoma, Arizona, New Mexico, Washington state and Montana have been identified.

ATF is conducting ongoing liaison with other foreign law and revenue enforcement authorities to ascertain the scope of cigarette trafficking worldwide. ATF is also currently working with criminal investigators and tax officials in East European countries to develop tobacco regulations and also establish criminal enforcement in this area. For more information contact Chief, Diversion Branch, (202)927-8210.

Salient Points

Statistics in article citing extent of contraband trafficking are too high.

Some companies within the Tobacco Industries appear knowledgeable about contraband trafficking. HOWEVER, corporate structure with International and Domestic Offices/Companies, appear in direct competition, i.e, a domestic office will be hurt by trafficking because it competes with their distribution system. ATF has worked with R.J.Reynolds, Philip Morris, etc. to obtain prop cigarettes, etc, and met to discuss counter-trafficking measures.

Created Diversion Branch to focus primarily on A/T criminal activity.

24-hr Cigarette Hotline to report thefts and hijacking of shipments involving 60,000+ cigarettes. (Established with ATF and the Federation of Tax Administrators)

Alcohol and Tobacco Database to track diversion and trafficking activity based on ATF criminal and regulatory investigations

Creating Diversion Assistance Team (DAT) composed of Special Agents, Inspectors, Auditors, and Intelligence personnel to assess and assist in diversion investigations

In 1996, ATF seized $804.373 in alcohol and tobacco, arrested 97 subjects, obtained 24 indictments, and obtained 6 successful prosecutions.

Criminal and civil violations include Internal Revenue Code (IRC), the Contraband Cigarette Trafficking Act (CCTA), Jenkins Act (not under our jurisdiction), and statutes relating to commerce with Indians, wire and mail fraud, money laundering, conspiracy and the Racketeer Influenced and Corrupt Organizations (RICO).

GW

ARONSON WASHINGTON RESEARCH

Mary Aronson **202-291-0654**

To: Tobacco Analyst, Portfolio Manager, Research Director

From: Mary Aronson

Date: September 25, 1997

Re: Shalala Testifies before Senate Labor & Human Resources Committee

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Secretary of Health and Human Services Donna Shalala told members of the Senate Labor and Human Resources Committee yesterday that the five goals President Clinton enumerated last week were the core elements of a tobacco settlement and would have to be included in any legislation before the Administration would consider industry immunity.

The five goals included:

- a comprehensive plan for combating teen smoking, including tough penalties against the industry if established targets are missed;
- full FDA authority to regulate tobacco similar to that which it has over drugs or devices;
- new business practices for the tobacco industry, including broad disclosure of industry documents;
- progress toward public health goals, including second-hand smoke, tobacco-cessation programs, international control efforts and research; and
- protection for tobacco farmers and their communities.

When some members of the committee expressed disappointment that the president had failed to send draft legislation to the Hill, Shalala emphasized the Administration's interest in working closely with congress in writing a bill. Translated from Washington-speak, this suggests that the tobacco settlement is such a political hot potato that neither branch of government wants to be caught holding the bag if whatever is developed backfires.

During the course of the three hour session, panel members peppered Shalala with questions about other issues which were not identified by the president in his long-awaited speech. These concerns included reimbursement for Medicare tobacco expenditures, whether to maintain the tobacco price support program, attorneys' fees, and more. Shalala's responses alternated between stressing that the Administration's primary emphasis was protection of teens, and assuring members that the White House would be happy to work with congress on other provisions once Clinton's goals were nailed down. However, the vast number of additional concerns identified by various senators throughout the three hour hearing suggests that the settlement may become so bogged down with special interests, that it is likely to stall. In such a situation, the easiest solution might be the passage of a measure everyone can agree to -- legislation to protect kids -- and not much more. (See AWR, 9/21/97.)

EK/
Tom

Should a kids-only bill be enacted, the Administration likely will push to have the power of administering the program in the FDA. When questioned by one senator about the wisdom of vesting all the power of a tobacco program with that agency, Shalala emphasized that smoking was a public health problem, and that the FDA, as the primary governmental health and safety agency, should justifiably be in charge.

Tom

Tobacco

View items related to this story

Legal Affairs

COSTLIER SMOKES, CLEANER LUNGS?

Why the payoff from higher tobacco prices may be elusive

When President Clinton laid out his policy on tobacco on Sept. 17, the centerpiece was a $1.50-per-pack increase in the price of cigarettes. Although Clinton didn't spell out the details, such a price hike would probably be spread out over several years and adjusted for inflation. But no matter how the mechanics of the concept are resolved, it is clear that his plan would sting smokers: the cost of a pack of smokes could easily climb by 80%, to a nation-wide average of about $3.50.

What is much less clear is whether a $1.50-per-pack price hike would achieve the President's top policy goal: cutting youth smoking in half by 2005. And that's not the only question surrounding the potential cigarette sticker shock. Would it create a massive black market? That's what happened in Canada in the early 1990s after the country raised tobacco taxes by more than 250%. In fact, bootlegging became such a problem that taxes were rolled back in 1994.

What about the tobacco industry's profits? Will they be pummeled? Enormous state and federal tax dollars are also at stake. Will overall cigarette levies decline? Although in many cases the answers can only be preliminary, close investigation reveals that a $1.50-per-pack price increase would affect far more than just smokers and tobacco companies. It would be one of the most important public-health initiatives in history, with far-reaching effects on everyone from taxpayers to retailers to law enforcement authorities.

The most critical issue surrounding the price hike is whether it would cut consumption by teens. According to Frank Chaloupka, a University of Illinois associate professor and an expert on the economics of smoking, a 10% increase in the price of cigarettes leads to a 6.75% decrease in the number of teens who smoke. Because a $1.50 price hike would increase the average nationwide cost of a pack of smokes by close to 80%, his studies suggest that teen smoking should fall by well over the desired 50%.

BLACK MARKET. But, as Chaloupka points out, the size of the proposed cigarette price spike is unprecedented. His nationwide studies are based on the small price fluctuations that have occurred in the past. Those and other factors, then, skew the correlations to his studies; the rate of decrease in teen smoking may slow down as the price hike climbs.

For one thing, a black market could develop that would supply youths with cheaper cigarettes, says Gary Black, a tobacco analyst with Sanford C. Bernstein & Co. Additionally, teens could trade down from Marlboro and Camel to discount brands (though Black and many health authorities note that younger smokers are particularly label-conscious). Retailers also may hold down prices to build store traffic, Black says.

Many health advocates, meanwhile, say that while a $1.50 increase would have a large impact if it were imposed immediately, the impact will be diminished if it is phased in gradually. Bottom line: The hike would certainly take a big bite out of teen smoking--but don't bet on cutting it in half.

Another contentious issue is whether a black market in cigarettes will emerge in reaction to a price jump. Pointing to Canada's experience--as well as that of Michigan, which saw a dramatic increase in smuggling after it raised cigarette taxes--the industry and its defenders are convinced that Clinton's plan would lead to a burgeoning market in contraband tobacco. "A black market always comes in to fill the gap" between places with high cigarette prices and those with lower ones, says Gary Auxier, senior vice-president of the National Smokers Alliance in Alexandria, Va.

DIFFERENT SCENARIO. Law enforcement authorities worry that this might create a profitable new line of business for organized crime. In Michigan--where the cigarette excise tax jumped from 25 cents in 1994 to 95 cents in 1996--Middle Eastern gangs that also specialize in illegal gambling have entered the trade, says Detective Sergeant James Ward, supervisor of the state police's Tobacco Products Tax Team.

But health authorities say that neither Canada's nor Michigan's experiences shed much light on what would happen if the U.S. adopted a national $1.50 price hike. Unlike Canada, which saw an uncontrollable influx of cigarettes from the U.S., the U.S. wouldn't be adjacent to any enormous source of contraband tobacco, says David Sweanor, of the Non-Smokers' Rights Assn. in Ottawa.

For one thing, Canada's provinces would likely greet an American price hike with an almost immediate tax increase of their own, Sweanor says. And the Mexican border is much more heavily policed. Trucking in large quantities of tobacco would be an iffy economic proposition--especially if the U.S. raised tobacco taxes, marked cigarette packs with easily visible tax stamps, and kept an eye on industry sales to northern Mexico, Sweanor says. And while interstate smuggling would certainly still exist, the relative importance of the small differences in state excise taxes would be less important if a nationwide price hike were enacted.

PROFIT LOSS. Of course, tobacco companies will feel the impact quickly. Their worst-case scenario would occur if Congress insisted that the entire $1.50-per-pack increase apply immediately--as many health groups wish. If that happens, Philip Morris Cos.' 1998 estimated operating profits from domestic tobacco would drop from $4.7 billion to $2.7 billion, says Black. Estimated earnings per share would probably drop from $3.15 per share to $2.90. At RJR Nabisco Inc., estimated domestic tobacco revenues would drop from $1.5 billion to about $950 million, while estimated earnings per share would fall from $3 to $2.35.

But an immediate price hike is unlikely--and to the extent that it is spread out over time, the earnings hit will diminish. It is also likely that much of the cost increase will come in the form of a penalty if youth-smoking reduction targets are not met. The faster the industry hits the targets, the lesser the price hike--and the smaller the impact on profits. Given the new advertising restrictions that Congress would probably create, Black also estimates that the industry's $6 billion in annual marketing expenses could drop by 20%.

Finally, the original tobacco settlement deal gave companies a broad antitrust exemption: They may "act in concert" to achieve "the goals of the agreement." If the provision remains in a new deal, Federal Trade Commission Chairman Robert Pitofsky warns that manufacturers may be able to increase profits by raising prices far above the level needed to pay for the settlement.

Will government coffers start overflowing from a cigarette tax hike? Until Congress decides how much of the $1.50-per-pack increase will come in the form of increased levies and how much will be in the form of penalties, it is impossible to predict how Clinton's plan would affect government treasuries. But tax increases, if they are imposed, won't necessarily guarantee more revenue. If they actually push down smoking, government receipts could actually decline. But then again, maybe that's a price the country is willing to pay.

By Mike France, with Peter Coy in New York and Susan Garland in Washington

RELATED ITEMS

TABLE: The $1.50 Effect

Tom

Published in The Orlando Sentinel, Thursday, September 11, 1997

Attorneys fight themselves over tobacco fees

By Scott Gold
SUN-SENTINEL, SOUTH FLORIDA

FORT LAUDERDALE -- For three years, they have been a united front, an imposing band of millionaire attorneys tirelessly pursuing the tobacco industry in the name of taxpayers, in the name of children.

Today, they are divided by money -- their paychecks.

In a legal dispute as testy as any that has taken place between the state and the cigarette makers, the members of the state's legal "Dream Team" are back in court, this time to argue among themselves.

Some members of the team -- including West Palm Beach lawyer Bob Montgomery and Fort Lauderdale lawyer Sheldon J. Schlesinger -- want to hold the state to its initial contract for legal services, which called for the team to receive 25 percent of Florida's winnings.

In August, the tobacco industry agreed to pay the state $11.3 billion over 25 years. That's about $5 billion in today's dollars, meaning the attorneys would be entitled to about $1.25 billion.

But the state says the settlement agreement, which calls for the tobacco industry to pay "reasonable" fees for attorneys, rendered the initial deal moot. Most of the state's trial team agrees. The rupture of the state's trial team is bitter and personal.

At one point Wednesday, Jacksonville lawyer Wayne Hogan, a member of the state's team who has not challenged the suit's settlement, tried to whisper into the ear of Pensacola lawyer Robert Kerrigan, who has.

"I'm not talking to you," Kerrigan said. "Sit down. Get away from me."

It has been less than two weeks since these same attorneys were remarking about their ability to fuse their sizeable egos into a unified effort.

"It's just very sad," said W.C. Gentry, a Jacksonville lawyer who supports the settlement agreement. "It is disappointing."

And it is ugly.

Four law firms, including Montgomery's and Schlesinger's, have filed "charging liens" claiming that they are owed 25 percent of any money deposited into the state's coffers by the tobacco industry.

On Wednesday, those firms filed a motion asking Circuit Judge Harold J. Cohen -- who was lauded as fair and just by both sides during the trial -- to recuse himself from the debate. Cohen was privy to negotiating discussions between the state and the industry that the trial team never heard, which could make him a witness in the case.

The bickering could delay the tobacco industry's first payment -- $750 million, due Monday.

Deputy Attorney General Peter Antonacci said after Wednesday's hearing that the state always intended for the industry, not taxpayers, to pay legal fees.

Antonacci referred to tobacco's initial payment as "the people's money." He said debate over fees should not delay the first payment, which includes $200 million for an anti-smoking campaign aimed at children.

"It's not the lawyers' money," he said.

Florida sued the tobacco industry three years ago, seeking to recover public funds spent to treat the poor with Medicaid programs for diseases linked to smoking. Forty other states have sued the industry, but Florida was the first to take its case to trial.

Jury selection was under way when the settlement was reached Aug. 25. A provision in the agreement calls for an independent panel to determine reasonable fees for attorneys.

The state's initial contract with the attorneys, however, clearly provides for fees equal to "25 percent of the recovery." Though they have worked on the case for three years, none of the attorneys has seen a dime.

Until Chiles announced the suit's settlement to the trial team at a dinner party hosted by Montgomery at his Palm Beach mansion, most of the state's team had no idea a deal had been reached.

The tobacco industry, meanwhile, asked Cohen on Wednesday for permission to wash its hands of the dispute. The industry wants to place its first payment into an escrow account supervised by the court.

"We're just saying we want to pay," said Murray R. Garnick, an industry attorney from Washington. "We want to pay it and let them resolve it amongst themselves."

[Posted 09/10/97 11:57 p.m. EST]

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The Miami Herald

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Page: 5B

LAWYERS MEET TO SETTLE FEES ON TOBACCO CASE

KAREN TESTA Associated Press

Attorneys involved in the state's $11 billion settlement with cigarette makers met peacefully for eight hours Friday to try to resolve a heated dispute over attorneys' fees.

No resolution was reached, but the length of the confidential discussions was significant since an attempt at bargaining last week ended with curse words and a walkout after 13 minutes.

The difference Friday? Former Palm Beach Chief Circuit Court Judge William Rutter served as a court-appointed referee.

``We're optimistic that significant progress has been made, as evidenced by the fact we've been here since 8:30 a.m.," said Harold Lewis, the governor's chief inspector general,.

The dispute hinges on how to pay the 12 attorneys who represented the state in its lawsuit against cigarette makers. Lead attorney Bob Montgomery and four others say the state should honor the contract, which provided for 25 percent of whatever the state recovered.

The settlement, reached Aug. 25, includes a provision that the attorneys be paid ``reasonable fees" by the tobacco industry, which the state contends makes it no longer responsible for paying them the agreed-to 25 percent, or $2.75 billion over 25 years.

The Miami Herald

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STATE'S TOBACCO LAWYERS FUME IN FLAP OVER FEES BILLIONS ANTICIPATED -- UNTIL SETTLEMENT

LORI ROZSA Herald Staff Writer

When the state decided to take on Big Tobacco, Gov. Lawton Chiles and his advisers knew they couldn't win it alone.

So they hired as their point man one of the best trial lawyers in the state, a ``fearless" bulldog who could face down tobacco and never blink.

Now that bulldog is biting them in the pants, and he won't let go.

Palm Beach attorney Bob Montgomery, whose goal was to ``put tobacco out of business," is fighting it out with the state over how much he should be paid. He and four other attorneys want 25 percent of the $11.3 billion settlement -- about $2.8 billion -- to be paid out over 25 years.

The state says forget it -- and is offering about $250 million -- ``a pretty damn good fee," the governor says.

The fight is already nasty.

Allegations of greed and conspiring with the enemy -- tobacco -- are flying, and all of it is tarnishing what was supposed to be a golden moment in state history.

``The fix was on," Montgomery says. ``The state got sucked in by tobacco."

``I guess we'll have to let the judge figure it out," says Pete Antonocci of the state attorney general's office.

Montgomery and the others -- Sheldon Schlesinger of Fort Lauderdale, Robert Kerrigan of Pensacola, Steven Yerrid of Tampa, James Nance of Melbourne -- say the state is reneging on a very clear deal.

The contract they signed when they took the case was approved by the Legislature and notes that the state had ``located the top lawyers in the state" who would be ``using their own money" to try the case.

``In light of the fact that the trial team is taking all the risks, and the fact that not a single case of this nature has ever been won . . . the state and the providers have agreed upon a fee of 25 percent of the recovery, plus out-of-pocket expenses incurred."

But the settlement instead says they'll get ``reasonable fees" to be determined by a panel of lawyers.

That's unacceptable to the five men who make a living out of fighting corporate giants.

``A deal's a deal," Schlesinger says. ``We were trying this case while they were settling it behind our backs. Now they won't pay their lawyers."

Chiles adviser Harold Lewis has said the five are ``trying to take children's money," because part of the settlement money is supposed to go to children's programs.

Agreement disputed

Chiles and his lawyers say the private legal team agreed to the new fee terms on the eve of the historic settlement.

``No, there was no agreement," Montgomery says. ``That is a pure fabrication."

Montgomery says it's not just about money. It's also about a deep hatred of cigarette makers. His father died of emphysema brought on by years of heavy smoking.

``I saw him gasp for breath in his last years."

He badly wanted to put the case before a jury. The jury pool of 70 people chosen during three weeks of questioning ``was dynamite," Montgomery said.

Trial observers said the state had a very strong case going to trial.

Depositions the trial team took from top cigarette executives came up with startling statements, including the admission that cigarettes can kill. Industry documents the team obtained and was prepared to show the jury highlighted practices that included marketing strategies apparently aimed at teenagers.

Wealthy attorney

``I had tobacco on its knees," Montgomery says, his chin out, his right fist making the point as he slugs it into his left palm. ``I knew my case. We were killing them in the focus groups. We were absolutely murdering them."

Montgomery, 67, is one of the richest lawyers in the state. He lives in a Palm Beach mansion. He is one of Palm Beach County's most generous philanthropists, donating millions to help build places as diverse as the Kravis Center for the Performing Arts, to Home Safe, a new center in Lake Worth for abused children.

``I've given away more money than I can say," Montgomery says.

He has earned more money than he cares to count. In his eight-page biography, he lists 56 cases under the heading ``Million Dollar Verdicts and Settlements."

He doesn't have an hourly rate, he charges on a contingency basis: 40-30-20: ``Forty percent of the first million, 30 percent of the second million and 20 percent of everything thereafter," he explains.

He successfully represented the late Kimberly Bergalis and other patients of dentist David Acer, in the first cases in which health worker was said to have infected his patients with the AIDS virus. Montgomery keeps a picture of a smiling Kimberly and her sisters in his office.

Multiple opponents

He has won personal injury verdicts against insurance companies, banks, hospitals and airlines.

Montgomery parks his two-tone silver Rolls-Royce in front of his office across from Clear Lake in West Palm Beach. Atheme running through the office, which he shares with partner Christopher Larmoyeux, is lions. The door knocker is a lion's head. A lamp is held up by a lion. He has lions in his inner office.

With his honey-toned southern drawl and crocodile hide suspenders, the University of Florida law school graduate (class of '57) looks and sounds the part of the good-ol'-boy attorney perfectly at home with the ``he-coon'' (Chiles' country-fied nickname) and the rest of the power elite in Tallahassee.

But he's doing everything he can to make them squirm and make them pay.

He says tobacco ``bought the state'' with this settlement, which could be replaced by the proposed ``global settlement'' with all the states that is being debated in Washington. More than 40 states have sued the industry. So far, Mississippi and Florida are the only cases to be decided.

High-stakes verdict

If the state had gone to trial and won against Big Tobacco, the verdict could have been for as much as $12.3 billion, and the bill would come due immediately. The settlement stretches the payments out over 25 years.

If the global agreement is approved by Congress, Florida will still get nearly the same amount from the industry that the settlement calls for. But the industry may get some assurances that cigarette makers have sought.

``Tobacco wants that global settlement because it gives them immunity,'' Montgomery says. ``Now they want to quell any dissent.''

Professor Richard Daynard of the Tobacco Products Liability Project at Northeastern University Law School in Boston said the Florida settlement is a ``tremendous accomplishment for public health.'' But if it had gone to trial, Daynard said the state most likely would have won and the trial would have been sorely embarrassing to tobacco.

What might have been

``The state would have been in there with a couple of juicy pieces of incriminating evidence every day,'' Daynard said.

It's the vision that Montgomery was savoring. He was hired by Chiles specifically to lead the trial team against tobacco on the advice of Pensacola attorney Fred Levin, who crafted the legislation that made it so easy for the state to sue the tobacco industry.

``Bob is fearless,'' Levin says. ``He's like the junkyard dog. I was very, very pleased that he was picked to be lead counsel."

Montgomery said he turned down Levin's invitation to join the anti-tobacco team at first, then agreed to take the job.

By late August, three weeks into jury selection, he was ready for a real dogfight and looking forward to it.

He said tobacco offered to settle for $6 billion.

``I told the governor, `Don't settle. Timing is everything, do not settle.' "

Chiles did not settle then. Two weeks later, tobacco offered $11.3 billion.

Chiles took it. The governor announced the stunning agreement at a Sunday night dinner party in the ballroom of Montgomery's Palm Beach mansion.

`I knew fix was on'

``I was astonished," Montgomery said. ``Right there, with all of them sitting in my ballroom, I knew the fix was on."

The settlement negotiations took place with a separate team of lawyers who hammered out the deal over the weekend and made it official Aug. 25. Montgomery said he wasn't told about the agreement until it was a done deal.

Chiles left the issue of attorneys' fees up to the lawyers and went to bed. The debate was rancorous from the start.

``Shelly [Schlesinger] told me to go wake up the governor," Montgomery said. ``I wasn't going to wake up the governor. He was a guest in my house."

Antonocci of the attorney general's office said everything was settled that night at Montgomery's mansion.

``The contract that was signed has been supplanted by the settlement agreement. There was a meeting, and the issue was put on the table," Antonocci said. ``Everybody marched into court the next day and smiled for the cameras."

Montgomery did not smile.

While the press and public scurried around the breezeway at the Palm Beach County Courthouse that morning, trying to get a better view of the governor as he announced the momentous settlement, Montgomery stood back behind the crowd. He summed up his feelings with one word: ``Stunned."

Now he's ready for another fight, but he doesn't like it.

``I cannot think of a more disappointing situation," Montgomery said. ``You'd expect you could believe in your state government."

WHO'S WHO OF LAWYERS THE FOLLOWING IS THE LIST OF ``THE PEOPLE'S ATTORNEYS," PRIVATE TRIAL LAWYERS HIRED BY THE STATE ON A CONTINGENCY

BASIS TO REPRESENT FLORIDA IN THE LAWSUIT AGAINST CIGARETTE MAKERS: * BOB MONTGOMERY , OF MONTGOMERY AND LARMOYEUX, WEST PALM BEACH. * SHELDON SCHLESINGER OF FORT LAUDERDALE. * ROBERT KERRIGAN, OF KERRIGAN, ESTESS, RANKIN AND MCLEOD, PENSACOLA. * C. STEVEN YERRID, OF YERRID, KNOPIK AND VALENZUELA, TAMPA.

* James Nance , of Nance, Cacciatore, Sisserson, Duryea and Hamilton, Melbourne.

* Ron Motley, of Ness, Motley, Loadholt, Richardson and Poole, Charleston, S.C.

* Richard Scruggs, of Scruggs, Millette, Lawson, Bozeman and Dent, Pascagoula, Miss.

* J. Wayne Hogan, of Brown, Terrell, Hogan, Ellis, McClamma and Yegelwel, Jacksonville.

* C. David Fonvielle, of Fonvielle and Hinkle, Tallahassee.

* W.C. Gentry, of Gentry and Phillip, Jacksonville.

* F. Timothy Howard, of Howard and Associates, Tallahassee.

* Michael Maher , of Maher, Gibson and Guiley, Orlando.

* R.W. Payne Jr., of Spence, Payne, Masington, Needle and Leeds, Miami.

*

One private attorney won't get a dime in the settlement.

Parker Thomson, a Miami attorney, worked on the case for free. He argued the constitutionality of the law that paved the way for the settlement and was in on the final settlement talks.

□□

The Miami Herald

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TOBACCO LAWYERS WALK OUT OVER FEES

Associated Press

A peace-making meeting between attorneys involved in the state's landmark tobacco lawsuit ended when three people stormed out of talks on lawyers' fees.

``I went in and . . . asked them, `Am I going to get my money?' " said Bob Montgomery, the leader of Florida's trial team. ``They said to get it from the tobacco companies."

Upon hearing that Monday, Montgomery stormed out, followed by colleagues Sheldon Schlesinger and Robert Kerrigan. The meeting lasted only 20 minutes.

The dispute hinges on how to pay the 12 attorneys who represented the state in its lawsuit against cigarette makers. Montgomery and four others say the state should honor the contract, signed more than two years ago, which provided for 25 percent of whatever the state recovered.

The state settled its lawsuit Aug. 25 for $11 billion. But the deal includes a provision that the attorneys be paid ``reasonable fees" by the tobacco industry.

State officials say the $11 billion is ``the people's money" and that the attorneys agreed to waive their contract in exchange for the settlement agreement. However, nothing like that is in writing.

Palm Beach County Circuit Judge Harold Cohen ordered the sides to try to settle the fees issue on their own. That now looks doubtful after Monday's flare-up.

``The question, it seems to me, is whether the attorneys are going to be fairly compensated," Deputy Attorney General Pete Antonacci said, ``and the answer to that question is `of course.' "

The Miami Herald

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LAWYERS TRUE TO FORM IN FIGHT FOR TOBACCO CUT

CARL HIAASEN Herald Columnist

Florida's landmark $11 billion settlement with the tobacco industry is being stymied by, of all things, lawyers.

Hard to believe, huh? Lawyers fighting over money.

As a result, the state's first $750 million check from cigarette makers, due to arrive Monday, will be deposited in a special account until the dispute is over.

At issue are legal fees and expenses, and the sums being debated are so huge as to be almost incomprehensible. Yet some lawyers recruited by Florida for the war on Big Tobacco say they're getting shafted, and in a perverse way they might be right.

Not that anyone has much sympathy for lawyers who stand to collect, in a worst-case scenario, $23 million each.

Here's what happened: To haul Big Tobacco to court, the state two years ago assembled a team of top personal-injury law firms. Their mission was to make the industry compensate Florida for health costs stemming from smoking-related diseases.

The contract would have given the attorneys 25 percent of any cash recovery, but the case never got to trial. Last month, the attorney general's staff negotiated that huge deal: $11 billion to be paid by the cigarette companies over 25 years.

The new agreement said legal fees would be decided by arbitration. Although a majority of Florida's hired-gun litigators went along with that, at least five did not.

They now have attached liens on the initial installment of the tobacco payout, and are seeking cuts of a $2.75 billion kitty -- 25 percent of the whole $11 billion enchilada.

That could bring windfalls of $200 million-plus to individual law firms. Gov. Lawton Chiles, among others, says they don't deserve it.

He told The Palm Beach Post that some of those big-name lawyers had counseled him to settle the case for $600 million -- a pittance compared to what Big Tobacco finally agreed to.

The governor said the attorneys deserve 25 percent of only the first $1 billion, or $250 million total.

An even split among the 11 law firms would come to about $23 million each.

That's still a humongous pile of money, but it's a much smaller pile than some of the lawyers want.

And if you can suppress your gag reflex, it's not impossible to see the unhappy faction's point of view. After all, Florida did promise fees of 25 percent. To change the terms now, after the settlement, seems cheesy.

On the other hand, a $2.75 billion fee seems downright obscene -- more than four times what Florida will spend this year building and maintaining all public schools and colleges.

Still, a deal's a deal. Sheldon Schlesinger, Bob Montgomery, Steve Yerrid, James Nance and Bob Kerrigan say they never endorsed the idea of fee arbitration, and seem miffed at their colleagues for agreeing to it.

Palm Beach Circuit Judge Harold Cohen, clearly an optimist, has directed the lawyers to iron things out privately. With only a couple billion dollars at stake, be assured the discussion will be calm, courteous and morally uplifting.

If the battle does go to arbitration, the three-member board will include one person chosen by the cigarette companies, one person chosen by the attorneys and one person who was neutral.

Together they'll decide what are ``reasonable" fees for Florida's all-star, anti-tobacco team -- ``reasonable" being a highly subjective concept.

Ordinary folks on the street would be hard-pressed to regard any fees beyond a measly few million dollars as reasonable. Which is why, of course, nobody's asking them .

The Miami Herald

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LAWYERS' TOBACCO-FEE FIGHT TURNS BITTER

ATTORNEYS WANT 25% OF $11 BILLION SETTLEMENT; STATE SAYS NO WAY

By KAREN TESTA Associated Press Associated Press

The dispute over attorneys' fees in the state's $11 billion tobacco settlement exploded Wednesday into a contentious courtroom battle with barbs cast in all directions -- including at the judge.

Four of the private lawyers who represented Florida are fighting the state, the tobacco industry -- even one another -- in an effort to get what they believe is their fair share of the deal.

The bottom line: The attorneys want 25 percent, the contingency fee they agreed to when they signed a contract with the state in February 1995. That would be about $1.25 billion, assuming the present value of the settlement, which is to be paid over 25 years, is about $5 billion, they say.

However, the landmark agreement in the state's lawsuit to recover Medicaid money spent on treating sick smokers says ``reasonable" attorneys' fees would be determined through arbitration and paid by the industry.

``We've had maybe too good of a result," said Steve Yerrid, a Tampa attorney. ``We did not agree to get money from tobacco. We agreed to get our money from the state of Florida."

Yerrid and three other attorneys have filed liens against the industry's first payment of $750 million -- due next Monday. They say they are entitled to 25 percent of every payment.

The state disagrees, saying the attorneys should seek their fees from cigarettemakers, not taking it from ``the people's money."

The tobacco industry is trying to steer clear of the dispute and has asked the judge for permission to make its first payment into an interest-bearing escrow account under the court's supervision.

``What we want to do is satisfy all our obligations," Murray Garnick, who represents Philip Morris Cos., said during a hearing Wednesday on the request.

However, the hearing was postponed until today after the attorneys who filed the liens asked Circuit Judge Harold Cohen to remove himself because he was consulted during settlement negotiations and could be called as a witness.

Cohen said he would rule on the recusal issue Thursday. Also in dispute is a motion by Attorney General Bob Butterworth to quash the attorneys' liens. Depending on the judge's decision on recusal, that could also be taken up today.

The settlement was negotiated privately -- and without the knowledge of many of the trial attorneys. Gov. Lawton Chiles announced the agreement at a dinner party for the trial team on Aug. 24 at the Palm Beach home of Bob Montgomery, the state's lead attorney.

The deal was signed in court Aug. 25 -- and all the attorneys stood with wide grins behind the governor during a news conference that followed.

The state now says the attorneys knew the agreement contained a provision for an arbitrator to determine their fees.

``The fees shouldn't cost the taxpayers a dime," Deputy Attorney General Pete Antonacci said.

Still, Montgomery said that there are ``gaps and ambiguities" in the agreement -- and that he never authorized anyone to speak for him during the negotiations.

Montgomery, Yerrid, Robert Kerrigan of Pensacola and Sheldon Schlessinger of Fort Lauderdale say their original contract should be honored. They are concerned cigarettemakers or a national settlement could delay their fees by years or significantly reduce them. Dozens of private attorneys worked on the state's case.

Many of the other attorneys, however, say they are comfortable with the state settlement.

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ATTORNEY: TOBACCO OWES US $1 BILLION

By MARK SILVA Capital Bureau Chief

First comes the booty: $11.3 billion that Florida will reap from cigarette makers.

Then come the lawyers.

The lead attorney for a ``dream team" of a dozen firms that fought the tobacco industry on behalf of the state figures their attorneys' fees at more than $1 billion.

``I have not calculated it -- my calculator won't go up that high," said Bob Montgomery, 67, a fabulously successful Palm Beach attorney whose excesses once ran to an outdoor chandelier in the rear parking-lot entrance to his law firm. ``This case is like any other -- except for the zeros."

The state won't pay a penny of this -- and cigarette makers aren't likely to pay much of it without another fight.

The legal team itself is split over what it is due. One billion ``is not going to happen . . . and I don't think anyone would think these are appropriate fees," said Tim Howard, another member of the state's team of private lawyers.

A historic, out-of-court settlement between Florida and Big Tobacco this week guaranteed that all $11.3 billion of what tobacco promises the state will go to public causes.

Gov. Lawton Chiles wants to spend it on health care for children and sickened smokers and a $200-million, two-year campaign against smoking among youths. Lawmakers want to spend some on schools, to alleviate crowding.

The agreement ensured that barristers wouldn't take a bite of this money.

Rather, cigarette makers agreed to pay the private lawyers $12 million -- roughly $1 million a firm -- to cover their expenses.

Arbitrators to decide fees

As far as any ``reasonable attorneys' fees" above and beyond the $12 million, the agreement signed Monday says that will be left to ``a panel of independent arbitrators."

Hooey, Montgomery says.

``I have fought these b------s for 3-1/2 years, and now I am to depend on them to tell me what they are going to pay me now?. . . Get out of here -- there is no damn way that is going to happen," Montgomery said. He promises a lawsuit of his own if tobacco won't cough up his fees.

Howard says Montgomery and others were well aware of the terms of the settlement signed Monday.

``A couple members don't like what happened. They complained about it, but they signed off on it," said Howard, an attorney in Tallahassee. ``The way it is going to turn out is they are going to get reasonable, appropriate fees [set] by a three-judge panel."

Scott Williams, a publicist for the cigarette companies that settled, won't comment on the claims for mammoth fees.

$100 million per firm?

Divided among 12 law firms, the billion-plus Montgomery seeks could amount to nearly $100 million apiece.

Had the lawsuit gone to trial, and had the state won, the lawyers -- by contract with the state -- would have claimed 25 percent of the award.

It's customary for trial lawyers to work on the contingency of winning -- no win, no fee.

And 25 percent is common. The actual amount paid to lawyers in long-term awards like this is calculated as a percentage of how much it would cost in current dollars. Montgomery calculates the current value of this settlement at about $5 billion.

`I'm not embarrassed'

Montgomery says $1 billion is only fair.

``Lawyers don't want to talk about their fees. They are so embarrassed. I am not embarrassed," Montgomery said. ``The state sought me out, asked me if I would be lead counsel if we filed in Palm Beach County, I worked 3 1/2 years, and now it's time to be paid."

His resume lists 56 multimillion-dollar verdicts and settlements.

If he casts any image of greed, he concedes the chandelier and Jaguar automobiles that adorned his old law office were excessive -- ``Yeah, that was a big ego trip. All of us have them some time." But he points to his community service and philanthropy -- as president of the Palm Beach Opera, chairman emeritus of the Palm Beach County Cultural Council.

Pro bono work

In this dust storm of high-paid attorneys and a powerful tobacco industry, one private attorney is walking away unpaid.

Parker Thomson, a Miami attorney who assists Attorney General Bob Butterworth without charge on many cases, argued the constitutionality of a law that Chiles won in 1994. This law, sneaked through a Legislature largely unaware of what it was doing, undermined the typical defenses that cigarette makers employ in lawsuits. It paved the way for this week's settlement.

Thomson's appearance before the Florida Supreme Court was pro bono. And Thomson -- though in on the final settlement talks -- is keeping his distance from the fee-deal the governor's lawyers struck with tobacco's lawyers, declining to comment on it.

``He is just a way smart guy," Pete Antonacci, deputy attorney general, said of Thomson.

WHO GETS THE MONEY

The principal lawyers, and their law firms, that stand to gain from Florida's $11.3 billion settlement with the nation's cigarette makers:

* Andy Berly and Ron Motley; Ness, Motley, Loadholt, Richardson and Poole; Charleston, S.C.

* David Fonvielle; Fonvielle and Hinkle; Tallahassee

* W.C. Gentry; Gentry and Phillips; Jacksonville

* Wayne Hogan; Brown, Terrell, Hogan, Ellis, McClamma and Yegelwel; Jacksonville

* Tim Howard; Howard and Associates; Tallahassee

* Robert Kerrigan; Kerrigan, Estess, Rankin and McLeod; Pensacola

* Mike Maher; Maher, Gibson and Guiley; Orlando

* Robert Montgomery; Montgomery and Larmoyeux; West Palm Beach

* James Nance; Nance, Cacciatore, Siserson, Duryea and Hamilton; Melbourne

* Sheldon Schlesinger; Sheldon J. Schlesinger, PA; Fort Lauderdale

* Richard Scruggs; Scruggs, Millette, Lawson and Dent; Pascagoula, Miss.

* Steven Yerrid; Yerrid, Knopik and Valenzuela; Tampa

Herald staff writer Lori Rozsa contributed to this report.

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FOX NEWS SUNDAY
AIRED ON SUNDAY, SEPTEMBER 21, 1997
WITH HOST: TONY SNOW
INTERVIEW WITH:
SENATOR DON NICKLES (R-OK)
SENATOR CARL LEVIN (D-MI)
WHITE HOUSE DOMESTIC POLICY ADVISOR BRUCE REED
SENATOR RICHARD LUGAR (R-IN)
AIR FORCE SECRETARY SHEILA WIDNALL

MR. SNOW: In the past 48 hours, the campaign finance investigation has changed dramatically. The Justice Department is now reviewing both President Clinton and Vice President Gore for possible violations of the law. And the Senate campaign finance hearings will shift for several weeks into a broad discussion of campaign finance reform.

Joining me to review the probe and look ahead are two key members of the committee, Senator Don Nickles from Oklahoma, and joining us from Detroit Senator Carl Levin. Also with me, Brit Hume, managing editor of Fox News in Washington.

MR. SNOW: Okay, gentlemen. We have many more ramifications we could look into. But I'm going to call it a day at that. Senator Carl Levin, thank you for joining us from Detroit. Senator Don Nickles, thank you as well.

Later on in the broadcast, we'll be joined by Jack Quinn who, in 1995 and '96 was both the chief of staff for Vice President Al Gore, and also the legal counsel for President Clinton. When we come back, however, why are tobacco companies doing a slow burn over the latest proposed tobacco deal?

PRESIDENT CLINTON (From videotape): Today, I want to challenge Congress to build on this historic opportunity by passing sweeping tobacco legislation that has one goal in mind, the dramatic reduction of teen smoking.

(Announcements.)

MR. SNOW: When the attorneys general of 40 states reached a settlement in which tobacco companies would pay $368 billion over 25 years, everyone hailed it as a great victory. Well, now President Clinton says he wants to make a few last minute changes, and members of Congress want a whack at it, too. To give us the White House perspective on the settlement talks, I'm joined by White House Domestic Policy Advisor Bruce Reed.

Good morning, Mr. Reed.

MR. REED: Good morning.

MR. SNOW: The question a lot of people have, and you hear it from tobacco interests especially, is that the president was involved in the negotiations, Bruce Lindsay was there from the start. They thought they had a deal, now he changed their mind. Why should they trust him?

MR. REED: Well, I think the president very much wants to pass comprehensive national legislation to reduce teen smoking. And we're proud of what the attorneys general were able to do to get us to this point. But, the president has been insistent all along that we need a plan that's going to work. So this week he called for tough penalties on the industry, that will hold the industry accountable for reducing teen smoking over the next decade. And we had broad bipartisan support, and the entire negotiating team of the attorneys general, as well.

MR. SNOW: Now, one of the key aspects of this is not merely that you want to reduce smoking, but you want to get a lot of money from the tobacco companies, and that's going to underwrite health care, correct?

MR. REED: Well, the president said that this really isn't about money. For us, the central goal is to reduce teen smoking. It may very well generate some money. But, our first preference would be to see teen smoking go down.

MR. SNOW: So why not simply propose a law that says, if you're a teen, we catch you smoking, you know, we throw the book at you? Why not make teens responsible for it, as well?

MR. REED: I think teens need to take responsibility and so to parents, but first and foremost the tobacco companies need to take responsibility. They've been marketing to children for years. We have 3,000 kids who take up smoking every day, 1,000 will die early as a result. And we want to put in place severe financial penalties that will change the industry's bottom line.

MR. SNOW: Well, the president -- okay, the president talks about critical this is for the nation's health. It's obviously a very important issue to him. If that's the case, it looks as if tobacco negotiations will drag on and on and on. Why doesn't he simply call a special session of Congress? For once Congress is going to get its work done on time this year, call them in, in December, and say, folks, we're going to focus on this. We're talking about thousands of lives, it's more pressing than anything a president has dealt with in recent years. Why not do that?

MR. REED: Well, we'd like Congress to get this done as quickly as possible. I think it's up to the congressional leadership what kind of calendar they want to set for themselves. But, we're confident that we've got the kind of bipartisan support that can get this done over the next year.

MR. SNOW: Will the president propose a bill?

MR. REED: The president put forward principles and has given --

MR. SNOW: No, I'm talking about a piece of legislation that says, we want this, this, this and this?

MR. REED: We'd like to work with Congress, members in both parties, to write a bill. We think it's more important to get a bill done than to worry about every last bit of fine print.

MR. SNOW: Well, on the other hand, is this not a bit of a set up for people in the House and Senate, on the other -- the president says, okay, I want these principles. If the language he doesn't like, he always has the opportunity to say, no, no, no, that's not good enough, I can veto. So he doesn't have to propose, but he can veto?

MR. SNOW: We've given them a clear road map. And we very much want to get this done. I don't think this has to become a partisan issue. I think there are Republicans and Democrats who are very concerned about reducing teen smoking and they'll work with the president to do it.

MR. SNOW: If Congress says, we want to keep in limits on liability, so that the court system can't keep churning out more and more costs, will he say okay?

MR. REED: We've always said that some kind of caps on liability are not a deal breaker for us. But, we would condition that on getting the kind of comprehensive plan to reduce teen smoking that we've asked for.

MR. SNOW: The final thing is, when would you like to see a deal done? Again, we keep talking about the urgency of it all. Is there some sort of bottom line date when the president wants to finish it up?

MR. REED: We'd like to see it get done over the next year. You know, about a million kids will take up smoking over the next year. We think that's enough time for Congress to do this.

MR. SNOW: Okay. Bruce Reed, thank you so much for joining us this morning.

Now, let us go to Indianapolis for the Republican reaction. I'd like to welcome Senate Agriculture Committee Chairman Richard Lugar.

Senator Lugar, welcome.

SEN. LUGAR: Good morning, Tony.

MR. SNOW: Let me open up, I want to read you a quote that Jessie Helms recently made about -- you know, about smoking. And what Senator Helms said is, somewhere along the line I hope we'll find out how many people starting smoking because they had a gun to their head. Your reaction?

SEN. LUGAR: Well, I think it's irrelevant. The fact is that many people started smoking and they continue to smoke, and this creates problems for their lives. As Bruce Reed pointed out, we are hopeful that young people will not start to smoke, with or without the gun at their head. And clearly one of the president's objectives, and that of many members of Congress, is to discourage teen smoking.

MR. SNOW: Along those lines, what do you think -- I was suggesting to Bruce Reed that maybe it's time to start throwing the book at teens, what do you think?

SEN. LUGAR: Well, I would agree. I think the general supposition is, and almost like prohibition, smoking is so general that any specific law enforcement is impossible. If that is the final judgment, so be it. But, I've suggested one way of making a big difference with teens right

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Tobacco's Road to 2000

While Congress and the White House dirty their hands with the proposed tobacco settlement, the action in at least two states could put the issue on the play list for the 2000 presidential campaign.

In all-important Iowa, the state's leading political writer, David Yepsen of *The Des Moines Register*, already appears to be the intersection between tobacco and White House politicking.

Presidential hopefuls needn't be surprised if Yepsen asks for their views on whether the tobacco industry should pay for state Medicaid costs due to cigarette smoking. The state recently sued the tobacco companies, though its prospects are iffy. Yepsen reported that state officials want Iowa lawmakers to "hold a special session to pass a bill strengthening the state's hand" in its lawsuit. Iowa's case "suffered a setback recently when a state district court judge ruled that Iowa does not have the legal right to sue to recover Medicaid expenses paid for smoking-related illnesses," Yepsen wrote. (*The Des Moines Register*, 9/7)

In Texas, Gov. George W. Bush, who's considered a possible Republican contender for the White House in 2000, presides over the state where the next tobacco lawsuit is expected to go to trial later this month. Many legal experts say the state could lose its lawsuit to recover Medicaid costs because Texas has no law that prevents tobacco companies from blaming smokers for their habit. Texas Attorney General Dan Morales said prospects for an out-of-court settlement of the state's $14 billion case were "essentially zero." (*The Dallas Morning News*, 8/27)

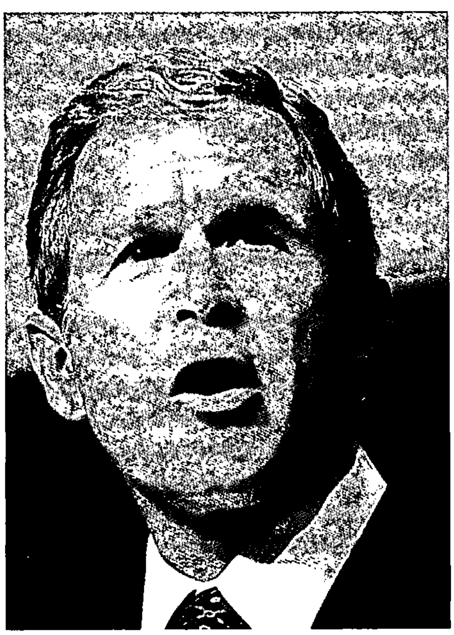
As a result, Bush is unlikely to find that suing the tobacco companies is the political winner it was for Florida Gov. Lawton Chiles, a Democrat. Chiles recently sparked a wave of favorable national publicity for the big-bucks settlement of his state's case, which was based upon a statute that stripped cigarette companies of their standard defense that smoking is an individual choice.

John Eisele

Frist: A lung surgeon stingy on teen smoking

The tobacco companies' leaders won't mind finding a friend or two among candidates willing to offer the industry some quiet support. The Clinton Administration's plans for the Food and Drug Administration to regulate nicotine, a dramatic change that Big Tobacco desperately fears, could well depend on whether the 43rd President is friendly to the idea.

In other tobacco news, *The Knoxville* (Tenn.) *News-Sentinel* couldn't resist a dig at Sen. Bill Frist, R-Tenn., for voting against an increase in federal funds to combat teen smoking. Noting that Frist, a medical doctor, voted "to cut the federal effort to $4.9 million," the newspaper described him as the only Senator who had "replaced many smokers' diseased lungs as a former lung transplant surgeon in Nashville." (9/4)



Richard A. Bloom

Bush: A winner from suing tobacco? Unlikely.

WHO'S ON FIRST?

A presidential election isn't much more than three years away, so surely it's time to begin the hoary arguments over whether the Iowa caucuses in February 2000 should kick off the electoral season. Republican National Committee chairman Jim Nicholson helped stir speculation during a recent visit to Iowa when he pointed out that another state could legally schedule a vote on the same day as Iowa's, but not before.

Noting that party rules prohibit "states from holding caucuses or primaries before" Iowa's caucus on the first Monday in February, Nicholson added: "Theoretically, somebody could jump on Iowa. Frankly, I don't think it's going to happen, but I don't know." (*Sioux City* [Iowa] *Journal*, 9/7)

FREE THE BOSTON ONE

Vice President Al Gore's staff has finally released *Boston Globe* reporter John Aloysius Farrell from his journalistic prison, letting him report his eyewitness account of the now-famous Buddhist temple event last year in Los Angeles.

Under the headline "Gore Avoided

bynl

President Clinton's Plan for Comprehensive Tobacco Legislation to Protect America's Children

Today, President Clinton challenged Congress to pass sweeping tobacco legislation to reduce teen tobacco use significantly. The President announced that he will invite Congressional leaders in both parties to the White House in the coming weeks to launch a bipartisan effort to enact federal tobacco legislation. That legislation will build on the extraordinary efforts of the nation's attorneys general, who helped create an historic opportunity for progress in reducing smoking, especially by youth.

In August 1996, the Clinton Administration announced a landmark rule by the Food and Drug Administration to protect children from the harm caused by tobacco products, which was upheld by a federal judge in North Carolina earlier this year. Those victories for the public health, along with the aggressive efforts of the attorneys general and leaders of the public health community, drove the tobacco companies to the bargaining table and extracted concessions that would have been unimaginable just a short time ago.

Since a proposed national settlement was announced June 20, the Administration -- led by Vice President Gore, Secretary of Health and Human Services Donna Shalala, and Domestic Policy Advisor Bruce Reed -- has been working with the public health community, the attorneys general, members of Congress, tobacco farmers, and others to develop a comprehensive tobacco policy.

Today, the President announced five key elements that must be at the heart of any national tobacco legislation:

1. **A Comprehensive Plan to Reduce Teen Smoking, Including Tough Penalties If Targets Are Not Met.** Every day, 3,000 young people start smoking regularly, and 1,000 of them will die early as a result. The central goal of tobacco legislation must be a comprehensive, nationwide effort to reduce teen smoking. The Administration is calling for:

- **Tough Penalties and Price Increases to Reduce Teen Smoking:** The Administration believes tobacco legislation must include stiff penalties that give the tobacco industry the strongest possible incentive to stop targeting kids. Legislation should set ambitious targets to cut teen smoking by 30% in 5 years, 50% in 7 years, and 60% in 10 years, and impose severe financial penalties that hold tobacco companies accountable to meet those targets. The Administration supports penalties that are non-deductible, uncapped, and escalating -- so that the penalties get stiffer and the price goes up the more that companies miss the targets. Reducing youth smoking is the Administration's bottom line, and now it must be the industry's bottom line.

Ardy

One of the surest ways to reduce youth smoking is to increase the price of cigarettes. By some estimates, a 10% increase in cigarette prices will lead to a 7% drop in youth smoking. **Today, the President called for a combination of industry payments and penalties to increase the price of cigarettes by up to $1.50 a pack over the next decade as necessary to meet the youth smoking reduction targets.**

- **A Public Education and Counter Advertising Campaign:** To succeed in reducing youth smoking, legislation must provide for a nationwide effort to deglamorize tobacco, warn young people of its addictive nature and deadly consequences, and help parents discourage their children from taking up the habit. Legislation should provide for a public education and counter advertising campaign, as well as state and local prevention efforts. The Administration also supports stronger, more visible warning labels on tobacco products.

- **Expanded Efforts to Restrict Access and Limit Appeal:** The current FDA rule includes significant measures to reduce youth access to tobacco products (such as requiring retailers to check photo identification of anyone under 27) and to limit the advertising of tobacco to young people (such as restricting advertising near school buildings). The Administration supports legislation codifying these measures, imposing even stronger restrictions on youth access and advertising consistent with the Constitution, and establishing an effective retail licensing scheme with tough penalties.

2. **Full Authority for FDA to Regulate Tobacco Products.** In 1996, the Administration took the historic step of asserting FDA jurisdiction over tobacco products. Since that time, the Administration has said it would support federal legislation explicitly affirming the FDA's authority to regulate the manufacture, marketing, and sale of tobacco products. Under such legislation, the FDA's authority over tobacco products must be as effective as its authority over other drugs and devices, and must be sufficiently flexible to meet changing circumstances. The legislation should not impose any obligation on the FDA to make specific findings about such speculative matters as the creation of contraband markets; nor should it impose any special procedural hurdles or requirements, such as enhanced standards of proof or unusual evidentiary formalities.

3. **Changes in the Way the Tobacco Industry Does Business.** Federal tobacco legislation must include measures to expose the industry's past misconduct, especially its efforts to market products to children, and to change the way the industry does business.

- **No Marketing to Children:** Commitments by the industry -- such as agreements to limit advertising to children -- can serve to recognize the need for increased corporate responsibility. Today, the President reiterated his call to the tobacco industry to stop marketing and promoting tobacco to children.

- **Document Disclosure:** To ensure that patterns of corporate malfeasance are disclosed and effectively checked in the future, tobacco legislation must provide for broad disclosure of industry documents, especially those containing scientific or other health information or relating to the industry's attempts to market tobacco to children. This legislation should respect essential principles of attorney-client privilege. But the legislation should establish effective mechanisms to turn over to the public all non-privileged documents, including documents the industry has inappropriately claimed to be privileged, as well as to disclose scientific and health-related information in even privileged documents.

- **Corporate Compliance:** Tobacco companies should set up comprehensive corporate compliance programs that will reinforce the real economic incentives provided by the youth smoking penalties to discourage companies from marketing to children. The legislation should establish oversight mechanisms to investigate and monitor corporate compliance and to make recommendations to Congress on appropriate future legislation.

4. **Progress Toward Other Public Health Goals.** Federal tobacco legislation provides an opportunity not only to reduce youth smoking, but to meet other public health goals: the reduction of environmental (second-hand) tobacco smoke, the expansion of smoking cessation programs, the strengthening of international efforts to control tobacco, and the provision of funds for health research and other health objectives.

- **Second-Hand Smoke:** The best scientific studies show that restrictions on second-hand smoke reduce the risk of death and injury to non-smokers, including the hundreds of thousands of children with asthma and other respiratory illness, and lead many smokers to quit the habit. Federal tobacco legislation should include provisions to restrict smoking in workplaces and other public facilities of the kind found in H.R. 3434, as well as in the President's recent Executive Order on tobacco smoke in federal facilities.

- **Smoking Cessation Programs:** Data suggests that some 70% of smokers want to quit, but fewer than 3% each year successfully do so. Legislation should help enable smoking cessation services to reach and assist the millions of smokers who want to break their addiction to tobacco products.

- **International Leadership:** According to the World Health Organization (WHO), tobacco use now causes 3 million deaths a year worldwide; unless checked, that number will rise to 10 million by 2025, with 70% of annual deaths occurring in developing countries. Legislation should strengthen global and bilateral efforts to reduce smoking by providing assistance to international institutions.

- **Resources for Health Research and Other Health Care Objectives:** The Administration believes that the primary objective of tobacco legislation is to reduce youth smoking, not to raise money. But tobacco legislation also should take into account the health costs associated with smoking and the resulting need for public health investments. Legislation should generate sufficient resources to establish a health research fund and contribute significantly to other important health objectives. In addition, Congress should repeal the provision giving the tobacco industry a $50 billion credit.

5. **Protection for Tobacco Farmers and Their Communities.** The President made clear today that any tobacco legislation must protect tobacco farmers and their communities. Most tobacco farmers live and work on small family farms; in many cases, their families have been growing tobacco for generations. In some states, entire communities rely on income from the tobacco crop. The Administration is committed to working with members of Congress in both parties to ensure that we protect the financial well-being of tobacco farmers, their families, and their communities.

tobacco

Elizabeth R. Newman
09/17/97 11:58:49 AM

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THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release September 17, 1997

REMARKS BY THE PRESIDENT
ON TOBACCO SETTLEMENT REVIEW

The Oval Office

10:55 A.M. EDT

THE PRESIDENT: Thank you very much. Mr. Vice President, Secretary Shalala, Secretary Glickman, thank you for your work. Thank you, Bruce Reed. I'd like to say a special word of thanks to David Kessler for the work he did -- historic work he did at the FDA when he was here. Thank you, Dr. Koop, and members of the public community who are here. To members of Congress, the Attorneys General, the representatives of plaintiffs in the private litigation -- and we have one of the injured parties here representing all of the them. We thank all of them for coming today.

This is a time of prosperity and hope and optimism for America, with our economy improving, making progress on our social problems, our efforts to lead the world to a more prosperous and peaceful future making headway. But I think we all know that this country still has some significant challenges, especially in the health field. And if we think about what we want America to be like in the 21st century, the health of our people and especially the health of our children must be paramount in our thinking, in our vision, and in our efforts.

That's why, a year ago, I worked with the FDA and we launched this nationwide effort to protect our children from the dangers of tobacco by reducing youth access to tobacco products, by preventing companies from advertising to our children.

The purpose of the FDA rule was to reduce youth smoking by 50 percent within seven years. Earlier this year, a federal judge in North Carolina said that the FDA has the authority to regulate tobacco products to protect the health of our children. There have also been other examples of litigation progress, as you know, brought by private plaintiffs and by the Attorneys General. Now, these victories for public health drove the tobacco companies to the bargaining table. They extracted concessions that would have been literally unthinkable just a short time ago.

I want to say a special word of thanks to the Attorneys General and the other parties who worked hard to negotiate this settlement. Everyone knows we would not be here had it not been for their foresight, their determination, and their relentless efforts.

Now we have this unprecedented opportunity to enact comprehensive tobacco legislation, working with all the parties involved -- the members of Congress, the attorneys general, the representatives of injured parties, the public health community, the tobacco farmers and others. We have moved from confrontation and denial and inertia to the brink of action on behalf of our children, and that is all to the good.

Today I want to challenge Congress to build on this historic opportunity by passing sweeping tobacco legislation that has one goal in mind: the dramatic reduction of teen smoking. In the

coming weeks I will invite congressional leaders from both parties to the White House to launch a bipartisan effort to enact such legislation.

There are five key elements that must be at the heart of any national tobacco legislation. Reducing teen smoking has always been America's bottom line. It must be the industry's bottom line. That is why I believe the first thing any tobacco legislation must include is a comprehensive plan to reduce teen smoking, including tough penalties. These penalties should be non-tax-deductible, uncapped, and escalating to give the tobacco industry the strongest possible incentive to stop targeting children as new customers.

One of the surest ways of reducing youth smoking is to increase the price of cigarettes. Today I call for a combination of industry payments and penalties to increase the price of cigarettes. Today I call for a combination of industry payments and penalties to increase the price of cigarettes by up to a dollar and a half a pack over the next decade, as needed, to meet our youth reduction targets. And I call upon the House to follow the lead of the United States Senate and repeal the provision giving the tobacco industry a $50 billion tax credit.

Second, any legislation must affirm the full authority of the FDA to regulate tobacco products. I believe the FDA's jurisdiction over tobacco products must be as strong and effective as its authority over drugs and devices. In particular, legislation cannot impose any special procedural hurdles on the FDA's regulation of tobacco products.

Third, effective legislation must include measures to hold the industry accountable, especially in any efforts to market products to children, while insisting on changes in the way it does business. I ask the industry again to make a voluntary commitment to stop advertising to children. And I call upon Congress to pass legislation providing for broad document disclosure so that the public can learn everything the tobacco companies know about the health effects of their products and their attempts to market to our children.

Fourth, federal tobacco legislation must aim not only to reduce youth smoking, but to meet other health goals as well. These include the reduction of secondhand smoke, the expansion of smoking prevention and cessation programs, the strengthening of international efforts to control tobacco, and the provision of funds for medical research and other important health objectives. We must build on the bipartisan agreement to fund children's health care in the recent balanced budget.

And finally, any tobacco legislation must protect tobacco farmers and their communities. We know that tobacco farmers are honest, hard-working people, most of whom live and work on small, family-owned farms. In some states, entire communities rely on income from the tobacco crop. Any legislation must protect these farmers, their families and their communities from loss of income.

Let me say in closing, I want to thank the Vice President, especially, who cares so passionately about this issue. He's played a key role in our efforts to protect our children from the dangers of tobacco. I've asked him to take the lead in building broad bipartisan support around the country for our plan. I also want to thank Secretary Shalala, Secretary Glickman and Bruce Reed, and all those who work so hard on our administration's analysis of the proposed settlement and where we are.

And finally, let me say again, we wouldn't be here if it weren't for all the people in this room and the countless others they represent around the country. To me, this is not about money. It is not about how much money we can extract from the tobacco industry. It is about fulfilling our duties as parents and responsible adults to protect our children and to build the future of this country. We are doing everything we can in this administration to give parents the tools they need to raise their children, but parents have to be our partners as well. If this is not just about money, we have to recognize that even beyond the tobacco company and all of us in this room, every parent in America has a responsibility to talk to their children about the dangers of tobacco, illegal drugs, and other things that can hurt them. We know if we have strong parental responsibility here, they can make a great deal of difference in protecting our children as well.

If we take responsibility, if we pass this legislation, if we do what we should here, if the tobacco industry will work with us, if other members of Congress in both parties will work with us, we will have gone a very long way toward creating the state of health for our children that will make America an even greater nation in the new century.

Thank you.

Q Mr. President, what are the chances of the Congress adopting your policy? And why is the industry so conspicuously absent?

THE PRESIDENT: Well, first of all, I was encouraged by some of the comments that were made by some industry representatives. I think that they know that they have to have federal legislation. They have an interest in that as well. And I would hope that they would be willing to work with us. But we cannot have the FDA crippled here, and we have to have real and meaningful penalties if the targets for youth smoking are not met. And so I feel very good about that.

I think the Congress -- I think it's highly likely that they will take action. When they take action depends, I think, upon when they can work through the issues for themselves and how they decide how to divide up the work among the committees. But it's not too soon to start. We could have hearings on this fairly soon, and I would hope to work with the Congress to develop a bill that would embody these principles.

Q Mr. President, you haven't said what you're willing to agree to for the tobacco industry. Are you will to agree to immunity from future liability?

THE PRESIDENT: Well, I don't think they've asked for future liability, I think they've asked for immunity from liability for past suits. And the question there would be, what are they willing to agree to. They need to come and meet with us. We need to discuss it, and we need to see whether we can embody these five principles. These are the things I'm interested in.

To me, I'll say again, this is not primarily about money. This is about changing the behavior of the United States, both the behavior of the tobacco companies, the behavior of the American people, the future behavior of our children. I'm trying to create an environment here with these five principles that I believe would achieve that. And if they want to be our partners in it, I think we can get there. And I hope they will be.

Q Are you willing to put your prestige on the line to ensure that this becomes law?

THE PRESIDENT: Well, I think my personal prestige on this has been on the line for more than a year now. (Laughter.) There for a while, I thought more than my prestige was on the line. (Laughter.) You know, for a person involved in public life in Washington today, personal prestige may be an oxymoron. (Laughter.) But at least you still have your neck most days.

Q What do you say to the people --

Q -- protect the well-being of tobacco farmers -- sounds like you're going to take away their livelihood.

THE PRESIDENT: Well, there are a number of things which can be done, and I don't want to get into the details. Secretary Glickman can talk about it. But we have had farmers in various sectors in our agriculture society facing constricted incomes before, and we have done things which helped them. There was a -- for example, I remember a few years ago something that affected dairy farmers in my state. There was a massive buy-out program for dairy farmers, and in a lot of states like Arkansas, there were any number of small farmers that were having a very difficult time who had a chance to start their life on a different basis.

I don't want to minimize this. Tobacco has a very high return per acre. So it's not a simple thing. You can't just say to a tobacco farmer to go plant soybeans, even if the soil will hold them. This is, from an agricultural point of view, economically complex. But, nonetheless, we have a responsibility to these people. They haven't done anything wrong. They haven't done anything illegal. They're good, hard-working, tax-paying citizens, and they have not caused this problem. And we cannot let them, their families or their communities just be crippled and broken by this. And I don't think any member of the public health community wants to do that. And the Agricultural Department and I am personally very committed to this part -- to me, this is one of the five things we have to do.

We're trying to change America and make everybody whole. And they deserve a chance to have their lives and be made whole and go on with the future as well, and I'm determined to see that they're a part of this.

Q What do you say to the attorneys who thought this was a good deal and very proudly proclaimed it?

THE PRESIDENT: Well, first of all, they were a part of all these ongoing reviews. Everybody was heard in this review process. And, secondly, they all recognize, too, that this agreement has to be ratified by Congress. The tobacco companies recognize that. That means that all of us who are part of that process are, in effect, parties to this case, too. And that's the way you need to look at this. We're building on their deal. We're not rejecting their agreement, we're building on it. We're not rejecting what the Attorneys General did, we're building on it. Look, if it hadn't been for what they did, we wouldn't be here.

I realize that there were two great things that started this. One is what Dr. Kessler and what we did at the FDA, and the fact that our administration was the first one ever willing to take this on. The other was the actions by the Attorneys General and the private lawsuits that got the disclosure of the documents that created a codal* change in the public attitude and the public efforts here.

And then long before that, there were the efforts of all of these people here from the public health community who have been telling us all this for years. And they had the public primed for it. Then, the lawsuits brought about the disclosures and then the FDA was moving. Those three things together, I think -- and, of course, now there have been a lot of congressional hearings. Representative Waxman had a full head of hair when he came to Congress before he started -- (laughter.) And so I think you've got to give -- to me, we're building on this progress, and that's the way you have to look at this. We are trying to do the best thing for the country in a way that is consistent with the agreement they made. We're building on the agreement. Were not tearing it down, we're building on it. And I think we can get legislation that will reflect it.

Thank you.

Q What do you think about the string of air crashes, Mr. President, that have happened -- Bosnia, the German representative that was killed?

THE PRESIDENT: It's a terrible thing. We don't have all the facts yet. I was briefed early this morning on it, and, obviously, I'm profoundly concerned for the diplomat and the people that were on the aircraft and their families. But I can't comment on the facts of it until we absolutely know what the facts are.

Q What about the other crashes?

THE PRESIDENT: I must say, we're making -- on balance, we're making some progress in Bosnia again. The events of the last several weeks are hopeful for the peace process and the Dayton Accord.

Q What about the other air crashes here in this country, this string of air accidents? What do you have to say about the air safety and what are you going to be doing about that?

THE PRESIDENT: I had a talk with the Secretary of Defense about them the day before yesterday, and I think we have to, first of all, analyze each and every one to see whether there is some pattern that would require some kind of review by the Air Force or whether it's just an unfortunate stream of coincidences that they all happened at the same time. I noted one that I learned about this morning involved Air National Guard planes, for example. That may or may not have anything to do with any problem with planes or anything like that.

I wouldn't over -- jump to conclusions about this. Remember, every year -- I try to say this once a year, so I want to say it now -- it is easy for the American people to forget the risks that our men and women in uniform undertake. Every year we lose a couple hundred people serving the United States in the military -- in peacetime. It is dangerous work. They have to be well-trained, they have to be skilled, they have to be brave. It is a difficult thing. I am heartsick about the plane we are missing off the coast of Africa that took a de-mining in there to continue our work against land mines.

But I don't want you to jump a conclusion that there is something because all these things occurred within a short space of time because, if you look over the course of a year, we may go months and months and months and nothing happens, but over the course of a year, we lose a significant number of people every year who serve our country in uniform because of the inherent risks involved in what they do.

We will do everything we can to make sure that they're as safe as possible, and if there is a pattern here that has to be looked into on air safety, you can be sure that the Air Force will do that.

Thank you.

Q Are you dreading Chelsea leaving home tomorrow?

THE PRESIDENT: Yes. This morning -- the first thing I did this morning we go look through the boxes and make sure we had all the right things in the right boxes. (Laughter.) But there's nothing I can do about it now. (Laughter.) That's what you raise them for. I'm happy and sad at the same time.

THE PRESS: Thank you.

END 11:17 A.M. EDT

Message Sent To:____

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Fax/ 202-456-2883

From: Gary Black

Ph/ 908-899-2219

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1999

Stock	Rtng	Price	YTD Perf.	Earnings 1996A	Earnings 1997E	Earnings 1998E	P/E 1997E	P/E 1998E	Rel P/E 1997E	Rel P/E 1998E	97-01E CGR %	EV / EBITA	Yield
MO	O	$41	+8	$2.56	$2.95	$3.15	13.9x	13.0x	66	67	14%	8.2	3.6%
RN	O	33	(4)	2.62	2.95	3.00	11.2	11.0	53	56	12	6.4	6.4
UST	O	31	(5)	2.42	2.45	2.67	12.7	11.6	61	60	9	6.9	5.7
SPX		947	+28	40.50	45.00	48.50	21.0	19.5	100	100	7	–	1.6

HIGHLIGHTS

1. We continue to put 80% odds that the June 20th settlement negotiated between the industry and attorneys general, with some of the changes offered by President Clinton, will be enacted as law by Congress next Spring. Stocks are likely to stagnate here until a favorable 4th Circuit ruling on FDA jurisdiction, which could produce a +5-10% pop.

2. We strongly disagree with the prevailing view in the press that the June 20th agreement is dead. Our Washington sources indicate it was politically necessary for the Administration to seed the idea in the media that there is a new deal: (a) to address the perception in Washington that the old deal was a bailout for the industry; (b) to overcome Congress' "not-invented here" syndrome; and (c) to get Dr. Kessler and Dr. Koop on board.

3. Concerns that Congress would pass a tobacco legislative deal with no liability protections for the industry seem misplaced: (a) without the industry's blessing, legislated advertising bans would likely not survive constitutional challenges; (b) the industry still has friends in the Republican leadership and in the thirteen tobacco growing states, which serve as an effective veto over an unsuitable deal; (c) adversarial relationship is not President Clinton's style.

4. We expect the industry to conclude that it can live with tougher penalties tied to youth smoking rates. Logic: If the industry does everything within its power to reduce youth smoking and fails, cigarette prices could be raised sharply as a *last resort* to achieve the youth smoking targets and avoid the stiff penalties -- causing profits to soar. This fits with our view that the domestic tobacco industry be placed back into a harvest mode, as it was during the 1980's.

5. Our biggest concern with the AG settlement is the soft cap on individual awards. If individual damage awards exceed $5 billion, the excess is rolled over into the following year. We would prefer a hard cap since this would eliminate investor uncertainty that Congress might ultimately raise the caps if the unmet liability became too high.

6. In speaking with AG Mike Moore and plaintiff attorney Richard Scruggs yesterday, we believe there will be major changes in the public relations effort now that President Clinton has taken an equity interest in this deal: (a) Koop and Kessler will lobby for the deal; (b) Moore plans to start a "death clock" to remind Congress that each day legislation is not passed 3,000 more kids will begin smoking; and (c) industry executives such as Geoff Bible and Steve Goldstone will become more proactive in their efforts to sell Congress the benefits of the deal.

INVESTMENT CONCLUSION

We reiterate outperform ratings on MO, RN, UST. While we are frustrated that the market has for now sided with the newspaper reports that suggest the original tobacco settlement is dead, we believe the tide will turn with a favorable ruling by the 4th Circuit panel, rejecting FDA jurisdiction (end of October), and a possible delay in the Texas Medicaid case if the 5th Circuit intervenes on mandamus prior to the September 29 trial. Unfortunately, we expect any rally to be short-lived given the anticipated lull in the resolution of the settlement as Congress adjourns from November to mid-January. Our 6-12 month price targets remain MO $60, RN $44, and UST $40, although we expect stocks to be only modesty higher (on the heels of a favorable 4th Circuit ruling) by year end.

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BERNSTEIN RESEARCH

Fax Problems Only - Call James Carberry (212) 756-4263

Gary Black (212) 756-4197 Jon Rooney (212) 756-4504 September 17, 1997

TOBACCO

Clinton Pulls Everyone Under The Tent. Lookback Penalties Could Be Avoided By Raising Prices.

Stock	Rtng	Price	YTD Perf.	Earnings 1996A	1997E	1998E	P/E 1997E	1998E	Rel P/E 1997E	1998E	97-01E CGR %	EV / EBITA	Yield
MO	O	$42	+13	$2.56	$2.95	$3.15	14.3x	13.4x	68	68	14%	8.5	3.8%
RN	O	33	(2)	2.62	2.95	3.00	11.2	11.0	53	56	12	6.3	6.2
UST	O	31	(4)	2.42	2.45	2.67	12.7	11.6	61	60	9	8.0	5.2
SPX		946	+28	40.50	45.00	48.50	21.0	19.5	100	100	7	--	1.6

"The report of my death was an exaggeration." Mark Twain

HIGHLIGHTS

1. We view President Clinton's tobacco settlement speech as fairly bullish; it appears that Dr. Kessler, Congressman Waxman, and Minnesota AG Skip Humphrey are all now on board, which greatly enhances odds of this deal passing. President Clinton offered broad, general themes of what he seeks in legislation, and offered few specifics other than full authority by the FDA over nicotine, stiff penalties if youth smoking rates fail to drop, and full disclosure of documents.

2. We expect the industry to embrace the President's position, although RJR and BAT are thought to remain deeply troubled by the proposed steep lookback pricing that would kick in after ten years if other measures to reduce teen smoking fail. Still, we don't see anyone walking away, given the potential to temper penalty provisions when Congress begins its review in 1998.

3. Many investors have failed to see that the industry could simply jack up prices by $1/pack or more by itself to achieve youth lookback targets, and thereby avoid the penalties spelled out by President Clinton. This rather bizarre conclusion -- that the industry could dodge what works out to be an incremental $.88/pack in penalties simply by raising prices sufficiently to achieve youth smoking targets, and then pocketing the excess profits -- would cause MO and RN earnings to soar.

4. With no chance of a deal being enacted this year, and still reeling from the public relations disaster associated with repeal of the $50 billion excise tax credit, we expect the industry to step back from the settlement debate, and wait for the 4th Circuit to rule on FDA jurisdiction, and try to convince the 5th Circuit to intervene on mandamus in the Texas Medicaid case.

5. We believe the 4th Circuit will reverse Judge Osteen and rule that the FDA cannot assert jurisdiction over tobacco. This would dramatically alter settlement dynamics, since absent FDA jurisdiction or further excise tax increases by Congress, the Administration would have no choice but to embrace the settlement to have any chance of reducing youth smoking.

6. In Texas, the parties will on Thursday ask Judge Folsom for dismissal of remaining claims. We expect Folsom to deny the motion, and deny the industry's request to certify the ruling to the 5th Circuit. The industry will seek mandamus review by the 5th Circuit, which is rare pre-trial, but could be granted by this conservative and traditionally pro-tobacco court. We still see no settlement in Texas, to send the message that absent a national settlement, the other 48 states will get no money.

7. Our Washington sources indicate that a standalone $1.50 - $2.00/pack excise tax would be dead on arrival, given a) an already worsening contraband market (30% of Michigan sales, 20% of New York sales) diverted from low-tax to high-tax states; b) Congressman from 13 tobacco-growing states won't likely endorse a tax hike of this magnitude; and c) Republican leadership is now likely to get on board this deal with President Clinton having offered political cover in today's speech.

8. <u>Downside</u>: If the industry walks, we could see a backlash against the industry in the current highly-charged political environment. This could cause Congress to pass a standalone $1.50/pack excise tax hike without liability protections. This would reduce Philip Morris 1998E earnings from $3.15 to $2.90, RJR 1998E earnings from $3.00 to $2.35, and assuming a proportional snuff tax increase, UST 1998E earnings from $2.67 to $2.60. Odds of the industry walking are remote.